

PATTERSON COMPANIES, INC.

Form 10-Q

March 08, 2017

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF
 1934

FOR THE QUARTERLY PERIOD ENDED January 28, 2017.

..TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF
1934

Commission File No. 0-20572

PATTERSON COMPANIES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Minnesota 41-0886515
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification Number)

1031 Mendota Heights Road 55120
St. Paul, Minnesota
(Address of Principal Executive Offices) (Zip Code)
(651) 686-1600
(Registrant’s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company) Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of March 3, 2017, there were 97,134,000 shares of Common Stock of the registrant issued and outstanding.

Table of Contents

PATTERSON COMPANIES, INC.
INDEX

	Page
<u>PART I - FINANCIAL INFORMATION</u>	
<u>Item 1 - Financial Statements</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of January 28, 2017 and April 30, 2016</u>	<u>3</u>
<u>Condensed Consolidated Statements of Income and Other Comprehensive Income for the Three and Nine Months Ended January 28, 2017 and January 30, 2016</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended January 28, 2017 and January 30, 2016</u>	<u>5</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>6</u>
<u>Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>14</u>
<u>Item 3 - Quantitative and Qualitative Disclosures about Market Risk</u>	<u>19</u>
<u>Item 4 - Controls and Procedures</u>	<u>20</u>
<u>PART II - OTHER INFORMATION</u>	
<u>Item 1 - Legal Proceedings</u>	<u>21</u>
<u>Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>21</u>
<u>Item 6 - Exhibits</u>	<u>22</u>
<u>Signatures</u>	<u>23</u>
<u>Exhibit Index</u>	<u>24</u>

Table of Contents

PART I—FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
PATTERSON COMPANIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	January 28, 2017 (Unaudited)	April 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 121,739	\$ 137,453
Receivables, net of allowance for doubtful accounts	810,155	796,693
Inventory	827,057	722,140
Prepaid expenses and other current assets	112,265	91,255
Total current assets	1,871,216	1,747,541
Property and equipment, net	300,395	293,315
Long-term receivables, net	107,511	88,248
Goodwill	813,094	816,592
Identifiable intangibles, net	434,386	509,297
Other	67,460	65,811
Total assets	\$3,594,062	\$3,520,804
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$547,662	\$566,253
Accrued payroll expense	72,297	75,448
Other accrued liabilities	155,740	151,134
Current maturities of long-term debt	14,754	16,500
Borrowings on revolving credit	198,000	20,000
Total current liabilities	988,453	829,335
Long-term debt	1,001,775	1,022,155
Other non-current liabilities	217,759	227,568
Total liabilities	2,207,987	2,079,058
Stockholders' equity:		
Common stock	974	991
Additional paid-in capital	66,274	48,477
Accumulated other comprehensive loss	(94,833)	(67,964)
Retained earnings	1,482,576	1,529,158
Unearned ESOP shares	(68,916)	(68,916)
Total stockholders' equity	1,386,075	1,441,746
Total liabilities and stockholders' equity	\$3,594,062	\$3,520,804
See accompanying notes		

Table of Contents

PATTERSON COMPANIES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME
 AND OTHER COMPREHENSIVE INCOME

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	January 28, 2017	January 30, 2016	January 28, 2017	January 30, 2016
Net sales	\$ 1,397,418	\$ 1,400,853	\$ 4,148,095	\$ 3,932,933
Cost of sales	1,067,657	1,060,989	3,182,196	2,973,926
Gross profit	329,761	339,864	965,899	959,007
Operating expenses	283,207	244,135	774,126	717,638
Operating income from continuing operations	46,554	95,729	191,773	241,369
Other income (expense):				
Other income, net	994	830	4,980	2,454
Interest expense	(11,400)	(10,634)	(31,659)	(39,931)
Income from continuing operations before taxes	36,148	85,925	165,094	203,892
Income tax expense	8,379	28,735	52,663	83,828
Net income from continuing operations	27,769	57,190	112,431	120,064
Net income (loss) from discontinued operations	(3,229)	(750)	(3,229)	1,500
Net income	\$ 24,540	\$ 56,440	\$ 109,202	\$ 121,564
Basic earnings (loss) per share:				
Continuing operations	\$ 0.29	\$ 0.60	\$ 1.18	\$ 1.23
Discontinued operations	(0.03)	(0.01)	(0.03)	0.01
Net basic earnings per share	\$ 0.26	\$ 0.59	\$ 1.15	\$ 1.24
Diluted earnings (loss) per share:				
Continuing operations	\$ 0.29	\$ 0.60	\$ 1.17	\$ 1.22
Discontinued operations	(0.03)	(0.01)	(0.03)	0.01
Net diluted earnings per share	\$ 0.26	\$ 0.59	\$ 1.14	\$ 1.23
Weighted average shares:				
Basic	94,737	95,335	95,252	97,809
Diluted	95,359	95,930	95,915	98,488
Dividends declared per common share	\$ 0.24	\$ 0.22	\$ 0.72	\$ 0.66
Comprehensive income				
Net income	\$ 24,540	\$ 56,440	\$ 109,202	\$ 121,564
Foreign currency translation gain (loss)	6,082	(18,679)	(28,176)	(23,013)
Cash flow hedges, net of tax	437	442	1,307	1,496
Comprehensive income	\$ 31,059	\$ 38,203	\$ 82,333	\$ 100,047
See accompanying notes				

Table of Contents

PATTERSON COMPANIES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In thousands)
 (Unaudited)

	Nine Months Ended	
	January 28, 2017	January 30, 2016
Operating activities:		
Net income	\$ 109,202	\$ 121,564
Net income (loss) from discontinued operations	(3,229)	1,500
Net income from continuing operations	112,431	120,064
Adjustments to reconcile net income from continuing operations to net cash used in operating activities:		
Depreciation	29,037	24,940
Amortization	34,019	33,877
Intangible asset impairment	36,312	—
Bad debt expense	1,013	6,546
Non-cash employee compensation	17,254	20,587
Accelerated amortization of debt issuance costs on early retirement of debt	60	5,153
Excess tax benefits from stock-based compensation	—	(1,750)
Change in assets and liabilities, net of acquired	(239,537)	(256,964)
Net cash used in operating activities- continuing operations	(9,411)	(47,547)
Net cash used in operating activities- discontinued operations	(3,229)	(38,985)
Net cash used in operating activities	(12,640)	(86,532)
Investing activities:		
Additions to property and equipment	(37,457)	(56,280)
Acquisitions and equity investments, net of cash assumed	—	(1,106,583)
Proceeds from sale of securities	—	48,744
Other investing activities	35,869	—
Net cash used in investing activities- continuing operations	(1,588)	(1,114,119)
Net cash provided by investing activities- discontinued operations	—	714,680
Net cash used in investing activities	(1,588)	(399,439)
Financing activities:		
Dividends paid	(70,947)	(67,010)
Repurchases of common stock	(84,651)	(200,000)
Proceeds from issuance of long-term debt	—	1,000,000
Debt issuance costs	—	(11,600)
Debt amendment costs	(1,266)	—
Retirement of long-term debt	(22,550)	(678,250)
Draw on revolver	178,000	198,000
Other financing activities	5,495	5,523
Net cash provided by financing activities	4,081	246,663
Effect of exchange rate changes on cash	(5,567)	(10,251)
Net change in cash and cash equivalents	(15,714)	(249,559)
Cash and cash equivalents at beginning of period	137,453	347,260
Cash and cash equivalents at end of period	\$ 121,739	\$ 97,701
See accompanying notes		

Table of Contents

PATTERSON COMPANIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars, except per share amounts, and shares in thousands)

(Unaudited)

Note 1. General

Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position of Patterson Companies, Inc. (referred to herein as "Patterson" or in the first person notations "we," "our," and "us") as of January 28, 2017, and our results of operations and cash flows for the periods ended January 28, 2017 and January 30, 2016. Such adjustments are of a normal recurring nature. The results of operations for the periods ended January 28, 2017 and January 30, 2016 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the financial statements included in our 2016 Annual Report on Form 10-K filed on June 29, 2016. The unaudited condensed consolidated financial statements include the assets and liabilities of PDC Funding Company, LLC ("PDC Funding") and PDC Funding Company II, LLC ("PDC Funding II"), which are our wholly owned subsidiaries and separate legal entities formed under Minnesota law. PDC Funding and PDC Funding II are fully consolidated special purpose entities established to sell customer installment sale contracts to outside financial institutions in the normal course of their business. The assets of PDC Funding and PDC Funding II would be available first and foremost to satisfy the claims of its creditors. There are no known creditors of PDC Funding or PDC Funding II.

Fiscal Year End

We operate with a 52-53 week accounting convention with our fiscal year ending on the last Saturday in April. The third quarter of fiscal 2017 and 2016 represents the 13 weeks ended January 28, 2017 and the 13 weeks ended January 30, 2016, respectively. The nine months ended January 28, 2017 and January 30, 2016 included 39 and 40 weeks, respectively. Fiscal 2017 will include 52 weeks and fiscal 2016 included 53 weeks of operations.

Comprehensive Income

Comprehensive income is computed as net income including certain other items that are recorded directly to stockholders' equity. Significant items included in comprehensive income are foreign currency translation adjustments and the effective portion of cash flow hedges, net of tax. Foreign currency translation adjustments do not include a provision for income tax because earnings from foreign operations are considered to be indefinitely reinvested outside the U.S. The income tax expense related to cash flow hedges was \$265 and \$268 for the three months ended January 28, 2017 and January 30, 2016, respectively. The income tax expense related to cash flow hedges was \$792 and \$618 for the nine months ended January 28, 2017 and January 30, 2016, respectively.

Earnings Per Share

The following table sets forth the computation of the weighted average shares outstanding used to calculate basic and diluted earnings per share ("EPS"):

	Three Months Ended		Nine Months Ended	
	January 28, 2017	January 30, 2016	January 28, 2017	January 30, 2016
Denominator for basic earnings per share – weighted average shares	94,737	95,335	95,252	97,809
Effect of dilutive securities – stock options, restricted stock and stock purchase plans	622	595	663	679
Denominator for diluted earnings per share – weighted average shares	95,359	95,930	95,915	98,488

Potentially dilutive securities representing 1,499 and 1,261 shares for the three and nine months ended January 28, 2017, respectively, and 941 and 753 shares for the three and nine months ended January 30, 2016, respectively, were excluded from the calculation of diluted earnings per share because their effects were anti-dilutive.

Table of Contents

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". ASU No. 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)," and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB deferred the effective date of this pronouncement by one year to December 15, 2017 for annual reporting periods beginning after that date. Early adoption is permitted, but not before the original effective date, which for annual periods was December 15, 2016. Companies may use either a full retrospective or a modified retrospective approach to adopt the standard. We plan to adopt the new guidance in the first quarter of fiscal 2019 and are currently evaluating the standard, including the method we will use for adoption and the effect it will have on our financial statements.

In July 2015, the FASB issued ASU No. 2015-11, "Inventory (Topic 330), Simplifying the Measurement of Inventory." ASU 2015-11 requires inventory measured using any method other than LIFO or the retail inventory method to be subsequently measured at the lower of cost or net realizable value, rather than at the lower of cost or market. Subsequent measurement of inventory using the LIFO and retail inventory method is unchanged. We are required to adopt the new pronouncement in the first quarter of fiscal 2018, and plan to do so at that time. Early adoption is permitted. We are evaluating the effect of adopting this pronouncement, but do not, at this time, anticipate a material impact to our financial statements once implemented.

In January 2016, the FASB issued ASU No. 2016-01 "Financial Instruments- Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)", which amends certain aspects of recognition, measurement, presentation and disclosure of financial instruments, including the requirement to measure certain equity investments at fair value with changes in fair value recognized in net income. We are required to adopt the ASU No. 2016-01 in the first quarter of fiscal 2019, with early adoption permitted. We are evaluating the impact of adopting this pronouncement.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," which requires lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by most leases, as well as requires additional qualitative and quantitative disclosures. We are required to adopt ASU 2016-02 in the first quarter of fiscal 2020, with early adoption permitted. We are evaluating the impact of adopting this pronouncement.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." ASU No. 2016-09 eliminates the additional paid-in capital pool concept and requires that excess tax benefits and tax deficiencies be recorded in the income statement when awards are settled. ASU No. 2016-09 also addresses simplifications related to statement of cash flows classification, accounting for forfeitures, and minimum statutory tax withholding requirements. During the first quarter of fiscal 2017, we adopted ASU No. 2016-09. As a result of this adoption, we recognized \$177 and \$2,169 of excess tax benefits related to share-based payments in our provision for income taxes for the three and nine months ended January 28, 2017, respectively. These items were historically recorded in additional paid-in capital. In addition, for the nine months ended January 28, 2017, cash flows related to excess tax benefits are classified as an operating activity along with other income tax cash flows. Prior periods have not been adjusted. Cash paid on employees' behalf related to shares withheld for tax purposes continues to be classified as a financing activity. Our share-based compensation expense in each period continues to reflect estimated forfeitures.

In August 2016, the FASB issues ASU No. 2016-15, "Statement of Cash Flows: Classification of Certain Cash Receipts and Payments." ASU No. 2016-15 provides guidance on eight specific cash flow issues with the objective of reducing diversity in practice. The guidance is effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted in any interim or annual period. During the third quarter of fiscal 2017, we adopted ASU No. 2016-15 and it had no material impact to the condensed consolidated financial statements.

Reclassifications

None.

Note 2. Discontinued Operations

In August 2015, we sold all of the outstanding shares of common stock of Patterson Medical Holdings, Inc., our wholly owned subsidiary responsible for our rehabilitation supply business ("Patterson Medical"), for \$716,886 in cash to Madison Dearborn Partners. As additional consideration for the shares of Patterson Medical, we obtained a number of common units of the parent company of the buyer equal to 10% of the common units outstanding at closing. Unlike the other common units, these units will only become entitled to begin participating in distributions to the common unit holders at such time, if any, as

7

Table of Contents

the Madison Dearborn Partners' investor cash inflows equal or exceed 2.5 times the Madison Dearborn Partners' investor cash outflows. These units are non-transferable.

In connection with the above described transaction, we also entered into a transition services agreement with our former subsidiary, pursuant to which Patterson Medical, as owned by Madison Dearborn Partners, is paying us to provide, among other things, certain information technology, distribution, facilities, finance, tax and treasury, and human resources services for up to 24 months after closing.

We classified Patterson Medical's results of operations as discontinued operations for all periods presented in the condensed consolidated statements of income and other comprehensive income. The operations and cash flows of Patterson Medical have been eliminated from our continuing operations, which were previously recorded as the rehabilitation supply reportable segment. Net sales from discontinued operations were \$168,504 for the nine months ended January 30, 2016. There were no net sales from discontinued operations for the three months ended January 30, 2016. For the three and nine months ended January 28, 2017, net loss from discontinued operations was \$3,229. This loss was due to a change in estimate of the tax impact of the sale of Patterson Medical.

Note 3. Customer Financing

As a convenience to our customers, we offer several different financing alternatives, including a third party program and a Patterson-sponsored program. For the third party program, we act as a facilitator between the customer and the third party financing entity with no on-going involvement in the financing transaction. Under our sponsored program, equipment purchased by customers with strong credit may be financed up to a maximum of \$1,000. We generally sell our customers' financing contracts to outside financial institutions in the normal course of our business. These financing arrangements are accounted for as a sale of assets under the provisions of ASC 860, Transfers and Servicing. We currently have two arrangements under which we sell these contracts.

First, we operate under an agreement to sell a portion of our equipment finance contracts to commercial paper conduits with The Bank of Tokyo-Mitsubishi UFJ, Ltd. ("BTMU") serving as the agent. We utilize PDC Funding to fulfill a requirement of participating in the commercial paper conduit. We receive the proceeds of the contracts upon sale to BTMU. At least 9% of the proceeds are held by the conduit as security against eventual performance of the portfolio. This percentage can be greater and is based upon certain ratios defined in the agreement with BTMU. The capacity under the agreement with BTMU at January 28, 2017 was \$575,000.

Second, we maintain an agreement with Fifth Third Bank ("Fifth Third") whereby the bank purchases customers' financing contracts. PDC Funding II sells financing contracts to Fifth Third. We receive the proceeds of the contracts upon sale to Fifth Third. At least 10% of the proceeds are held by the conduit as security against eventual performance of the portfolio. This percentage can be greater and is based upon certain ratios defined in the agreement with Fifth Third. The capacity under the agreement with Fifth Third at January 28, 2017 was \$100,000.

We retain servicing responsibilities for the financing contracts under both arrangements, for which we are paid a servicing fee. The servicing fees we receive are considered adequate compensation for services rendered. Accordingly, no servicing asset or liability has been recorded.

The portion of the purchase price for the receivables held by the conduits is deemed a deferred purchase price receivable, which is paid to the applicable special purpose entity as payments on the customers' financing contracts are collected from customers. The difference between the carrying amount of the receivables sold under these programs and the sum of the cash and fair value of the deferred purchase price receivables received at time of transfer is recognized as a gain on sale of the related receivables and recorded in net sales in the condensed consolidated statements of income and other comprehensive income. Expenses incurred related to customer financing activities were recorded in operating expenses in our condensed consolidated statements of income and other comprehensive income.

During the three and nine months ended January 28, 2017 we sold \$106,272 and \$278,529, respectively, of contracts under these arrangements. During the three and nine months ended January 30, 2016 we sold \$128,442 and \$271,381, respectively, of contracts under these arrangements. We recorded net sales in the condensed consolidated statements of income and other comprehensive income of \$2,450 and \$16,966 during the three and nine months ended

January 28, 2017, respectively, related to these contracts sold. We recorded net sales in the condensed consolidated statements of income and other comprehensive income of \$8,814 and \$23,717 during the three and nine months ended January 30, 2016, respectively, related to these contracts sold.

8

Table of Contents

Included in cash and cash equivalents in the condensed consolidated balance sheets are \$22,363 and \$27,186 as of January 28, 2017 and April 30, 2016, respectively, which represent cash collected from previously sold customer financing contracts that have not yet been settled. Included in current receivables in the condensed consolidated balance sheets are \$96,284, net of unearned income of \$2,914, and \$87,406, net of unearned income of \$1,768, as of January 28, 2017 and April 30, 2016, respectively, of finance contracts we have not yet sold. A total of \$619,361 of finance contracts receivable sold under the arrangements was outstanding at January 28, 2017. The deferred purchase price under the arrangements was \$128,015 and \$108,837 as of January 28, 2017 and April 30, 2016, respectively. Since the internal financing program began in 1994, bad debt write-offs have amounted to less than 1% of the loans originated.

The arrangements require us to maintain a minimum current ratio and maximum leverage ratio. We were in compliance with those covenants at January 28, 2017.

Note 4. Derivative Financial Instruments

We are a party to certain offsetting and identical interest rate cap agreements entered into to fulfill certain covenants of the equipment finance contract sale agreements. The interest rate cap agreements also provide a credit enhancement feature for the financing contracts sold by PDC Funding and PDC Funding II to the commercial paper conduit.

The interest rate cap agreements are canceled and new agreements are entered into periodically to maintain consistency with the dollar maximum of the sale agreements and the maturity of the underlying financing contracts.

As of January 28, 2017, PDC Funding had purchased an interest rate cap from a bank with a notional amount of \$575,000 and a maturity date of November 2023. We sold an identical interest rate cap to the same bank. As of January 28, 2017, PDC Funding II had purchased an interest rate cap from a bank with a notional amount of \$100,000 and a maturity date of July 2024. We sold an identical interest rate cap to the same bank.

These interest rate cap agreements do not qualify for hedge accounting treatment and, accordingly, we record the fair value of the agreements as an asset or liability and the change as income or expense during the period in which the change occurs.

In March 2008, we entered into two forward starting interest rate swap agreements, each with notional amounts of \$100,000 and accounted for as cash flow hedges, to hedge interest rate fluctuations in anticipation of the issuance of the senior notes due fiscal 2015 and fiscal 2018. Upon issuance of the hedged debt, we settled the forward starting interest rate swap agreements and recorded a \$1,000 increase, net of income taxes, to other comprehensive income (loss), which is being amortized as a reduction to interest expense over the life of the related debt.

In January 2014, we entered into a forward interest rate swap agreement with a notional amount of \$250,000 and accounted for as cash flow hedge, to hedge interest rate fluctuations in anticipation of refinancing the 5.17% senior notes due March 25, 2015. These notes were repaid on March 25, 2015 and replaced with new \$250,000 3.48% senior notes due March 24, 2025. A cash payment of \$29,003 was made in March 2015 to settle the interest rate swap. This amount is recorded in other comprehensive income (loss), net of tax, and is recognized as interest expense over the life of the related debt.

The following presents the fair value of derivative instruments included in the condensed consolidated balance sheets:

Derivative type	Classification	January April	
		28, 2017	30, 2016
Assets:			
Interest rate cap agreements	Other noncurrent assets	\$ 2,069	\$ 816
Liabilities:			
Interest rate cap agreements	Other noncurrent liabilities	2,069	816

The following table presents the pre-tax effect of derivative instruments in cash flow hedging relationships on the consolidated statements of income and other comprehensive income ("OCI"):

Amount of Gain (Loss)
Reclassified from Accumulated
Other Comprehensive Loss into
Income (Effective Portion)

Edgar Filing: PATTERSON COMPANIES, INC. - Form 10-Q

		Three Months	Nine Months
		Ended	Ended
		January	January
Derivatives in cash flow hedging relationships	Income statement location	28, 2017	30, 2016
Interest rate swap	Interest expense	\$(702)	\$(2,099)
		\$(710)	\$(2,115)

9

Table of Contents

We recorded no effective portion of gains or losses on derivative instruments in cash flow hedging relationships in OCI during the current period.

We recorded no ineffectiveness during the three and nine month periods ended January 28, 2017 and January 30, 2016. As of January 28, 2017, the estimated pre-tax portion of accumulated other comprehensive loss that is expected to be reclassified into earnings over the next twelve months is \$2,809, which will be recorded as an increase to interest expense.

Note 5. Fair Value Measurements

Fair value is the price at which an asset could be exchanged in a current transaction between knowledgeable, willing parties. The fair value hierarchy of measurements is categorized into one of three levels based on the lowest level of significant input used:

Level 1 - Quoted prices in active markets for identical assets and liabilities at the measurement date.

Level 2 - Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Unobservable inputs for which there is little or no market data available. These inputs reflect management's assumptions of what market participants would use in pricing the asset or liability.

Our hierarchy for assets and liabilities measured at fair value on a recurring basis is as follows:

January 28, 2017

	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents	\$1,821	\$1,821	\$—	\$—
Deferred purchase price receivable	128,015	—	—	128,015
Derivative instruments	2,069	—	2,069	—
Total assets	\$131,905	\$1,821	\$2,069	\$128,015
Liabilities:				
Derivative instruments	\$2,069	\$—	\$2,069	\$—

April 30, 2016

	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents	\$14,609	\$14,609	\$—	\$—
Deferred purchase price receivable	108,837	—	—	108,837
Derivative instruments	816	—	816	—
Total assets	\$124,262	\$14,609	\$816	\$108,837
Liabilities:				
Derivative instruments	\$816	\$—	\$816	\$—

Cash equivalents – We value cash equivalents at their current market rates. The carrying value of cash equivalents approximates fair value and maturities are less than three months.

Deferred purchase price receivable – We value the deferred purchase price receivable based on a discounted cash flow analysis using unobservable inputs, which include a forward yield curve, the estimated timing of payments and the credit quality of the underlying creditor. Significant changes in any of the significant unobservable inputs in isolation would not result in a materially different fair value estimate. The interrelationship between these inputs is insignificant.

Derivative instruments – Our derivative instruments consist of interest rate cap agreements and interest rate swaps. These instruments are valued using inputs such as interest rates and credit spreads.

Certain assets are measured at fair value on a non-recurring basis. These assets are not measured at fair value on an ongoing basis, but are subject to fair value adjustments under certain circumstances, such as when there is evidence of

Table of Contents

impairment. There were no fair value adjustments to such assets during the nine month periods ended January 28, 2017 or January 30, 2016.

Our debt is not measured at fair value in the condensed consolidated balance sheets. The estimated fair value of our debt as of January 28, 2017 and April 30, 2016 was \$1,024,576 and \$1,064,752, respectively, as compared to a carrying value of \$1,016,529 and \$1,038,655 at January 28, 2017 and April 30, 2016, respectively. The fair value of debt was measured using a discounted cash flow analysis based on expected market based yields (i.e., level 2 inputs). The carrying amounts of receivables, net of allowances, accounts payable, and certain accrued and other current liabilities approximated fair value at January 28, 2017 and April 30, 2016.

Note 6. Income Taxes

The effective income tax rate from continuing operations for the three months ended January 28, 2017 was 23.2% compared to 33.4% for the three months ended January 30, 2016, and for the nine months ended January 28, 2017 was 31.9% compared to 41.1% for the nine months ended January 30, 2016. The decrease in the rate for the three months ended January 28, 2017 was primarily due to a change in estimate of the tax impact of the cash repatriation and a geographical shift in profit due to the non-cash impairment charge related to our decision not to extend sales exclusivity with Sirona Dental Systems. The decrease in the rate for the nine months ended January 28, 2017 was primarily due to the prior year impact of cash repatriation and transaction-related costs incurred in connection with the acquisition of Animal Health International, Inc. In addition, the current period rates included excess tax benefits from the adoption of ASU No. 2016-09 of \$177 and \$2,169 for the three and nine months ended January 28, 2017, respectively.

In the first quarter of fiscal 2016, we approved a one-time repatriation of approximately \$200,000 of foreign earnings. This one-time repatriation reduced the overall cost of funding the acquisition of Animal Health International, Inc. In addition, certain foreign cash at Patterson Medical was required to be repatriated as part of the sale transaction. The continuing operations tax impact of \$12,300 from the repatriation was recorded during the first nine months of fiscal 2016. During the third quarter of fiscal year 2017, we recorded a \$2,406 benefit related to a change in estimate of the tax impact of the cash repatriation in the third quarter of fiscal year 2017.

Note 7. Intangible Asset Impairment

In the first quarter of fiscal 2006, we extended our exclusive North American distribution relationship with Sirona Dental Systems for Sirona's CEREC 3D dental restorative system. At that time, we paid a \$100,000 distribution fee to extend the existing exclusive relationship for at least a 10-year period beginning in 2007. This distribution fee has been accounted for as an intangible asset in our Dental segment that has been amortized since October 2007.

Based on our November 2016 decision not to extend sales exclusivity for the full Sirona portfolio of products, we recorded a pre-tax non-cash impairment charge of \$36,312 in our Dental segment in the third quarter fiscal 2017, related to the distribution fee associated with the CEREC product component of this arrangement. This charge was recorded within operating expenses in the condensed consolidated statements of income and other comprehensive income.

Note 8. Segment Reporting

We present three reportable segments: Dental, Animal Health and Corporate. Dental and Animal Health are strategic business units that offer similar products and services to different customer bases. Dental provides a virtually complete range of consumable dental products, equipment and software, turnkey digital solutions and value-added services to dentists, dental laboratories, institutions, and other healthcare professionals throughout North America. Animal Health is a leading, full-line distributor in North America and the U.K. of animal health products, services and technologies to both the production-animal and companion-pet markets. Our Corporate segment is comprised of general and administrative expenses, including home office support costs in areas such as information technology, finance, legal, human resources and facilities. In addition, customer financing and other miscellaneous sales are reported within Corporate results. Corporate assets consist primarily of cash and cash equivalents, accounts receivable, property and equipment and long-term receivables. We evaluate segment performance based on operating income. The costs to operate the fulfillment centers are allocated to the operating units based on the through-put of the

unit.

11

Table of Contents

The following table presents information about our reportable segments:

	Three Months Ended		Nine Months Ended	
	January 28, 2017	January 30, 2016	January 28, 2017	January 30, 2016
Net sales				
Dental	\$626,343	\$637,651	\$1,782,911	\$1,814,090
Animal Health	762,577	749,713	2,332,354	2,081,463
Corporate	8,498	13,489	32,830	37,380
Consolidated net sales	\$1,397,418	\$1,400,853	\$4,148,095	\$3,932,933
Operating income (loss) from continuing operations				
Dental	\$40,018	\$82,108	\$177,356	\$223,454
Animal Health	23,777	25,959	60,460	64,108
Corporate	(17,241)	(12,338)	(46,043)	(46,193)
Consolidated operating income from continuing operations	\$46,554	\$95,729	\$191,773	\$241,369

	January 28, 2017	April 30, 2016
Total assets		
Dental	\$906,181	\$994,113
Animal Health	2,169,246	2,064,302
Corporate	518,635	462,389
Total assets	\$3,594,062	\$3,520,804

The following table presents sales information by product for all of our reportable segments:

	Three Months Ended		Nine Months Ended	
	January 28, 2017	January 30, 2016	January 28, 2017	January 30, 2016
Net sales				
Consumable	\$1,064,098	\$1,059,838	\$3,252,551	\$3,042,634
Equipment and software	249,047	248,779	627,187	610,071
Other	84,273	92,236	268,357	280,228
Consolidated net sales	\$1,397,418	\$1,400,853	\$4,148,095	\$3,932,933

Note 9. Accumulated Other Comprehensive Loss ("AOCL")

The following table summarizes the changes in AOCL as of January 28, 2017:

	Cash Flow Hedges	Currency Translation Adjustment	Total
AOCL at April 30, 2016	\$(16,734)	\$(51,230)	\$(67,964)
Other comprehensive loss before reclassifications	—	(28,176)	(28,176)
Amounts reclassified from AOCL	1,307	—	1,307
AOCL at January 28, 2017	\$(15,427)	\$(79,406)	\$(94,833)

The amounts reclassified from AOCL during fiscal 2017 represent gains and losses on cash flow hedges, net of taxes of \$792. The impact to the condensed consolidated statements of income and other comprehensive income was an increase to interest expense of \$2,099.

Table of Contents

Note 10. Legal Proceedings

In September 2015, we were served with a summons and complaint in an action commenced in the U.S. District Court for the Eastern District of New York, entitled SourceOne Dental, Inc. v. Patterson Companies, Inc., Henry Schein, Inc. and Benco Dental Supply Company, Civil Action No. 15-cv-05440-JMA-GRB. SourceOne, as plaintiff, alleges that, through its website, it markets and sells dental supplies and equipment to dentists. SourceOne alleges in the complaint, among other things, that we, along with the defendants Henry Schein and Benco, conspired to eliminate plaintiff as a competitor and to exclude them from the market for the marketing, distribution and sale of dental supplies and equipment in the U.S. and that defendants unlawfully agreed with one another to boycott dentists, manufacturers, and state dental associations that deal with, or considered dealing with, plaintiff. Plaintiff asserts the following claims: (i) unreasonable restraint of trade in violation of state and federal antitrust laws; (ii) tortious interference with prospective business relations; (iii) civil conspiracy; and (iv) aiding and abetting the other defendants' ongoing tortious and anticompetitive conduct. Plaintiff seeks equitable relief, compensatory and treble damages, jointly and severally, punitive damages, interest, and reasonable costs and expenses, including attorneys' fees and expert fees. We are vigorously defending ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial condition.

Beginning in January 2016, purported class action complaints were filed against defendants Henry Schein, Inc., Benco Dental Supply Co. and Patterson Companies, Inc. Although there were factual and legal variations among these complaints, each alleged that defendants conspired to foreclose and exclude competitors by boycotting manufacturers, state dental associations, and others that deal with defendants' competitors. On February 9, 2016, the U.S. District Court for the Eastern District of New York ordered all of these actions, and all other actions filed thereafter asserting substantially similar claims against defendants, consolidated for pre-trial purposes. On February 26, 2016, a consolidated class action complaint was filed by Arnell Prato, D.D.S., P.L.L.C., d/b/a Down to Earth Dental, Evolution Dental Sciences, LLC, Howard M. May, DDS, P.C., Casey Nelson, D.D.S., Jim Peck, D.D.S., Bernard W. Kurek, D.M.D., Larchmont Dental Associates, P.C., and Keith Schwartz, D.M.D., P.A. (collectively, the "putative class representatives") in the U.S. District Court for the Eastern District of New York, entitled In re Dental Supplies Antitrust Litigation, Civil Action No. 1:16-CV-00696-BMC-GRB. Burkhardt Dental Supply Company, Inc. was added as a defendant on October 22, 2016. Subject to certain exclusions, the putative class representatives seek to represent all persons who purchased dental supplies or equipment in the U.S. directly from any of the defendants, since August 31, 2008. In the consolidated class action complaint, putative class representatives allege a nationwide agreement among Henry Schein, Benco, Patterson and Burkhardt not to compete on price. The consolidated class action complaint asserts a single count under Section 1 of the Sherman Act, and seeks equitable relief, compensatory and treble damages, jointly and severally, interest, and reasonable costs and expenses, including attorneys' fees and expert fees. Putative class representatives have not specified a damage amount in their complaint. While the outcome of litigation is inherently uncertain, we believe the consolidated class action complaint is without merit, and we are vigorously defending ourselves in this litigation.

Note 11. Debt

During fiscal 2016, we entered into a credit agreement (the "Credit Agreement"), under which the lenders provided us with senior unsecured lending facilities of up to \$1,500,000, consisting of a \$1,000,000 unsecured term loan and a \$500,000 unsecured revolving line of credit. The Credit Agreement was due to expire in fiscal 2021.

In the third quarter of fiscal 2017, we entered into an amendment of the Credit Agreement (the "Amended Credit Agreement"), consisting of a \$295,075 term loan and a \$750,000 revolving line of credit. Interest on borrowings is variable and is determined as a base rate plus a spread. This spread, as well as a commitment fee on the unused portion of the facility, is based on our leverage ratio, as defined in the Amended Credit Agreement. The term loan and revolving credit facilities will mature no later than January 2022.

As of January 28, 2017, \$295,075 of the Amended Credit Agreement unsecured term loan was outstanding at an interest rate of 2.27%, and \$198,000 was outstanding under the Amended Credit Agreement revolving line of credit at an interest rate of 2.22%. At April 30, 2016, \$317,625 was outstanding under the Credit Agreement unsecured term

loan at an interest rate of 1.81%, and \$20,000 was outstanding under the Credit Agreement revolving line of credit at an interest rate of 3.88%.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Form 10-Q for the period ended January 28, 2017, contains certain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995, which may be identified by the use of forward-looking terminology such as "may", "will", "expect", "anticipate", "estimate", "believe", "goal", or "continue", or comparable terminology that involves risks and uncertainties that are qualified in their entirety by cautionary language set forth herein, in our 2016 Annual Report on Form 10-K filed June 29, 2016, and in other documents previously filed with the Securities and Exchange Commission.

OVERVIEW

Our financial information for the first nine months of fiscal 2017 is summarized in this Management's Discussion and Analysis and the Condensed Consolidated Financial Statements and related Notes. The following background is provided to readers to assist in the review of our financial information.

We present three reportable segments: Dental, Animal Health and Corporate. Dental and Animal Health are strategic business units that offer similar products and services to different customer bases. Dental provides a virtually complete range of consumable dental products, equipment and software, turnkey digital solutions and value-added services to dentists and dental laboratories throughout North America. Animal Health is a leading, full-line distributor in North America and the U.K. of animal health products, services and technologies to both the production-animal and companion-pet markets. Our Corporate segment is comprised of general and administrative expenses, including home office support costs in areas such as information technology, finance, legal, human resources and facilities. In addition, customer financing and other miscellaneous sales are reported within Corporate results.

In August 2015, we divested our wholly-owned subsidiary Patterson Medical Holdings, Inc. ("Patterson Medical"), the entity through which we operated the rehabilitation supply business. We classified the results of operations of Patterson Medical as discontinued operations for all periods presented in the condensed consolidated statements of income and other comprehensive income.

Operating margins of the animal health business are considerably lower than the dental business. While operating expenses run at a lower rate in the animal health business when compared to the dental business, gross margins in the animal health business are substantially lower due generally to the low margins experienced on the sale of pharmaceutical products.

We operate with a 52-53 week accounting convention with our fiscal year ending on the last Saturday in April. The third quarter of fiscal 2017 and 2016 represents the 13 weeks ended January 28, 2017 and the 13 weeks ended January 30, 2016, respectively. The nine months ended January 28, 2017 and January 30, 2016 included 39 and 40 weeks, respectively. Fiscal 2017 will include 52 weeks and fiscal 2016 included 53 weeks of operations.

We believe there are several important aspects of our business that are useful in analyzing it, including: (1) growth in the various markets in which we operate; (2) internal growth; (3) growth through acquisition; and (4) continued focus on controlling costs and enhancing efficiency. Management defines internal growth as the increase in net sales from period to period, excluding the impact of changes in currency exchange rates, and excluding the net sales, for a period of twelve months following the transaction date, of businesses we have acquired.

The following significant activities occurred in the first nine months of fiscal 2017 or 2016:

Enterprise Resource Planning System Initiatives. In the third quarter of fiscal 2017, we completed the application development stage of our enterprise resource planning ("ERP") system, and we began depreciating our investment in such system. We incurred increased depreciation and other operating expenses of approximately \$11.0 million in the three months ended January 28, 2017 as compared to the three months ended January 30, 2016, and approximately \$15.0 million in the nine months ended January 28, 2017 as compared to the nine months ended January 30, 2016, related to this implementation.

Intangible Asset Impairment. In the first quarter of fiscal 2006, we extended our exclusive North American distribution relationship with Sirona Dental Systems for Sirona's CEREC 3D dental restorative system. At that time, we paid a \$100.0 million distribution fee to extend the existing exclusive relationship for at least a 10-year period beginning in 2007. This distribution fee has been accounted for as an intangible asset that has been amortized since

October 2007. Based on our November 2016 decision not to extend sales exclusivity for the full Sirona portfolio of products, we recorded a pre-tax non-cash impairment charge of \$36.3 million, or \$23.0 million after taxes or \$0.24 per diluted share in our Dental segment in the third quarter of fiscal 2017, related to the distribution fee associated with the CEREC product component of this arrangement.

Table of Contents

Animal Health International Acquisition. In June 2015, we completed the acquisition of Animal Health International, Inc., a leading production animal health distribution company in the U.S. Prior to our acquisition, Animal Health International, Inc. generated sales and earnings before interest, income taxes, depreciation and amortization of \$1.5 billion and \$68 million, respectively, during the 12 months ended March 2015. Our acquisition more than doubled the revenue of our legacy animal health business, which was previously focused on the companion animal market. Our animal health business now offers an expanded range of products and services to a broader base of customers in North America and the U.K. During the nine months ended January 30, 2016, we incurred \$10.0 million, or \$0.10 per diluted share, on an after-tax basis, of transaction costs in the acquisition of Animal Health International, Inc.

Patterson Medical Sale. In August 2015, we sold Patterson Medical for \$716.9 million. See Note 2 to the Condensed Consolidated Financial Statements for additional information.

Cash Repatriation. In the first quarter of fiscal 2016, we approved a one-time repatriation of approximately \$200.0 million of foreign earnings. This one-time repatriation reduced the overall cost of funding the acquisition of Animal Health International, Inc. In addition, certain foreign cash at Patterson Medical was required to be repatriated as part of the sale transaction. A continuing operations tax impact of \$12.3 million from the repatriation was recorded during the first nine months of fiscal 2016. During the third quarter of fiscal 2017, we recorded a \$(2.4) million tax benefit related to a change in estimate of the tax impact of the cash repatriation.

RESULTS OF OPERATIONS**QUARTER ENDED JANUARY 28, 2017 COMPARED TO QUARTER ENDED JANUARY 30, 2016****Continuing Operations**

The following table sets forth, for the periods indicated, the percentage of net sales represented by certain operational data from continuing operations:

	Three Months Ended	
	January 28, 2017	January 30, 2016
Net sales	100.0 %	100.0 %
Cost of sales	76.4	75.7
Gross profit	23.6	24.3
Operating expenses	20.3	17.5
Operating income from continuing operations	3.3	6.8
Other income (expense)	(0.7)	(0.7)
Income from continuing operations before taxes	2.6	6.1
Income tax expense	0.6	2.0
Net income from continuing operations	2.0 %	4.1 %

Net Sales. Consolidated net sales for the three months ended January 28, 2017 were \$1,397.4 million, a decrease of 0.2% from \$1,400.9 million for the three months ended January 30, 2016. Foreign exchange rate changes had an unfavorable impact of 1.6% on current quarter sales.

Dental segment sales for the three months ended January 28, 2017 were \$626.3 million, a decrease of 1.8% from \$637.7 million for the three months ended January 30, 2016. Current quarter sales of consumables decreased 2.6%, due primarily to the sales force realignment effected in the first quarter of fiscal 2017. Sales of dental equipment and software decreased 0.8% to \$230.4 million. Sales of other dental services and products decreased 1.1%.

Animal Health segment sales for the three months ended January 28, 2017 were \$762.6 million, an increase of 1.7% from \$749.7 million for the three months ended January 30, 2016. Foreign exchange rate changes had an unfavorable impact of 3.2% on current quarter sales growth. Sales of certain products previously recognized on a net basis were recognized on a gross basis during the three months ended January 28, 2017, resulting in a 2.0% favorable impact to sales.

Gross Profit. Consolidated gross profit margin for the three months ended January 28, 2017 decreased 70 basis points from the prior year quarter to 23.6%. The decrease in the gross profit margin rate was predominantly driven by our Dental segment, which experienced lower consumables and equipment gross margins. In addition, a greater

percentage of sales came

15

Table of Contents

from our lower margin Animal Health segment during the three months ended January 28, 2017, resulting in a lower consolidated gross profit margin rate.

Operating Expenses. Consolidated operating expenses for the three months ended January 28, 2017 were \$283.2 million, a 16.0% increase from the prior year quarter of \$244.1 million. The increase was predominantly the result of the \$36.3 million intangible asset impairment charge recognized in the current quarter in our Dental segment, as well as increased expenses related to our ERP system initiatives. The consolidated operating expense ratio of 20.3% increased 280 basis points from the prior year quarter, also driven primarily by the impairment charge and the increased expenses related to our ERP initiatives.

Operating Income From Continuing Operations. For the three months ended January 28, 2017, operating income from continuing operations was \$46.6 million, or 3.3% of net sales, as compared to \$95.7 million, or 6.8% of net sales for the three months ended January 30, 2016. The decrease in operating income from continuing operations was driven by the intangible asset impairment charge in our Dental segment and increased expenses related to our ERP system initiatives, as well as lower gross margins in our Dental and Corporate segments. The decrease in operating income as a percent of sales was driven by these same factors.

Dental segment operating income was \$40.0 million for the three months ended January 28, 2017, a decrease of \$42.1 million from the prior year quarter. The decrease in operating income was due primarily to the intangible asset impairment charge, as well as lower gross margins and increased expenses related to our ERP system initiatives.

Animal Health segment operating income was \$23.8 million for the three months ended January 28, 2017, a decrease of \$2.2 million from the prior year quarter. The decrease was primarily driven by higher operating expenses related to our ERP system initiatives.

Corporate segment operating loss was \$17.2 million for the three months ended January 28, 2017, as compared to a loss of \$12.3 million for the three months ended January 30, 2016. The change was driven primarily by lower net sales related to our customer financing contracts.

Other Income (Expense). Net other expense for the three months ended January 28, 2017 was \$10.4 million, compared to \$9.8 million for the three months ended January 30, 2016. The increase was mainly due to higher interest expense in the current quarter.

Income Tax Expense. The effective income tax rate from continuing operations for the three months ended January 28, 2017 was 23.2% compared to 33.4% for the three months ended January 30, 2016. The decrease in the rate for the three months ended January 28, 2017 was primarily related to a change in estimate of the tax impact of the cash repatriation and a geographical shift in profit due to the non-cash impairment charge related to our decision not to extend sales exclusivity with Sirona Dental Systems.

Net Income and Earnings Per Share From Continuing Operations. Net income from continuing operations for the three months ended January 28, 2017 was \$27.8 million, compared to \$57.2 million for the three months ended January 30, 2016. Earnings per diluted share from continuing operations were \$0.29 in the current quarter compared to \$0.60 in the prior year quarter. Weighted average diluted shares outstanding in the current quarter were 95.4 million, compared to 95.9 million in the prior year quarter. The current quarter cash dividend was \$0.24 per common share compared to \$0.22 in the prior year quarter.

Discontinued Operations

For the three months ended January 28, 2017 and January 30, 2016, net loss from discontinued operations was \$3.2 million and \$0.8 million, respectively. The net loss incurred during the three months ended January 28, 2017 was due to a change in estimate of the tax impact of the sale of Patterson Medical.

NINE MONTHS ENDED JANUARY 28, 2017 COMPARED TO NINE MONTHS ENDED JANUARY 30, 2016**Continuing Operations**

The following table sets forth, for the periods indicated, the percentage of net sales represented by certain operational data from continuing operations:

Table of Contents

	Nine Months Ended	
	January 28, 2017	January 30, 2016
Net sales	100.0 %	100.0 %
Cost of sales	76.7	75.6
Gross profit	23.3	24.4
Operating expenses	18.7	18.3
Operating income from continuing operations	4.6	6.1
Other income (expense)	(0.6)	(0.9)
Income from continuing operations before taxes	4.0	5.2
Income tax expense	1.3	2.1
Net income from continuing operations	2.7 %	3.1 %

Net Sales. Consolidated net sales for the nine months ended January 28, 2017 were \$4,148.1 million, an 5.5% increase from \$3,932.9 million for the nine months ended January 30, 2016. The inclusion of Animal Health International, Inc. results for approximately six additional weeks in the nine months ended January 28, 2017 had a 4.9% favorable impact on sales. One less week of results in the current period had an estimated 1.5% unfavorable impact on sales growth, and foreign exchange rate changes had an unfavorable impact of 1.8% on current period sales growth. Dental segment sales for the nine months ended January 28, 2017 were \$1,782.9 million, a 1.7% decrease from \$1,814.1 million for the nine months ended January 30, 2016. One less week of results in the current period had an estimated 1.6% unfavorable impact on sales. Current period sales of consumables decreased 4.1%, primarily due to having one less week of results in the current period and to the sales force realignment. Sales of dental equipment and software increased 2.4% to \$586.4 million for the nine months ended January 28, 2017. Sales of other dental services and products decreased 1.3% for the nine months ended January 28, 2017.

Animal Health segment sales for the nine months ended January 28, 2017 were \$2,332.4 million, a 12.1% increase from \$2,081.5 million for the nine months ended January 30, 2016. Incremental sales attributed to the acquisition of Animal Health International, Inc. contributed 9.3% to this sales growth. In addition, sales of certain products previously recognized on a net basis were recognized on a gross basis during the nine months ended January 28, 2017, resulting in a 2.9% favorable impact to sales. Foreign exchange rate changes had an unfavorable impact of 3.3% on current period sales growth.

Gross Profit. Consolidated gross profit margin for the nine months ended January 28, 2017 decreased 110 basis points from the prior year period to 23.3%. The decrease in the gross profit margin rate was predominantly the result of the inclusion of sales and cost of sales from Animal Health International, Inc. in our results for a full nine months in the current year, as that business traditionally has lower gross margins than our historical businesses. In addition, the Animal Health segment gross margin rate declined when compared to the prior year period, primarily as a result of pricing pressure from branded pharmaceutical manufacturers.

Operating Expenses. Consolidated operating expenses for the nine months ended January 28, 2017 were \$774.1 million, a 7.9% increase from the prior year period of \$717.6 million. The increase was predominantly the result of the \$36.3 million intangible asset impairment charge recognized in the current period in our Dental segment, increased expenses related to our ERP system initiatives and the inclusion of Animal Health International, Inc. results for a full three quarters in the current year period, partially offset by reduced transaction costs related to the acquisition of Animal Health International, Inc. The consolidated operating expense ratio of 18.7% increased 40 basis points from the prior year period. The increase in this ratio was driven by the impairment charge and increased expenses related to our ERP initiatives, partially offset by the inclusion of sales and operating expenses from Animal Health International, Inc. in our results for a full nine months in the current year, as that business traditionally has a lower operating expense ratio than our historical businesses.

Operating Income From Continuing Operations. For the nine months ended January 28, 2017, operating income from continuing operations was \$191.8 million, or 4.6% of net sales, as compared to \$241.4 million, or 6.1% of net sales for the nine months ended January 30, 2016. The decrease in operating income from continuing operations was driven

by the impairment charge and increased expenses related to our ERP system initiative. The decrease in operating income as a percent of sales was mainly due to these same factors.

17

Table of Contents

Dental segment operating income was \$177.4 million for the nine months ended January 28, 2017, a decrease of \$46.1 million from the prior year period. The decrease was driven primarily by the impairment charge, increased expenses related to our ERP system initiatives and lower sales volumes as a result of having one less week of results in the current period.

Animal Health segment operating income was \$60.5 million for the nine months ended January 28, 2017, a decrease of \$3.6 million from the prior year period. The decrease was primarily driven by lower gross margins, which decreased as a result of pricing pressure from branded pharmaceutical manufacturers, as well as increased expenses related to our ERP system initiatives. Lower bad debt expense in the current period partially offset these factors.

Corporate segment operating loss was \$46.0 million for the nine months ended January 28, 2017, as compared to a loss of \$46.2 million for the nine months ended January 30, 2016. The change was driven primarily by reduced transaction costs related to the acquisition of Animal Health International, Inc., partially offset by lower net sales related to our customer financing contracts and increased legal expenses in the nine months ended January 28, 2017. Other Income (Expense), Net. Net other expense was \$26.7 million for the nine months ended January 28, 2017, compared to \$37.5 million for the nine months ended January 30, 2016. The decrease was mainly due to \$5.2 million of accelerated debt issuance cost amortization incurred in the nine months ended January 30, 2016, as well as lower debt levels in the current period.

Income Tax Expense. The effective income tax rate for the nine months ended January 28, 2017 was 31.9% compared to 41.1% for the nine months ended January 30, 2016. The decrease in the rate was primarily due to the prior year impact of cash repatriation and transaction-related costs incurred in the acquisition of Animal Health International, Inc. In addition, the current period rate included excess tax benefits from the adoption of ASU No. 2016-09. See Note 1 to the Condensed Consolidated Financial Statements for additional information on this adoption.

Net Income and Earnings Per Share From Continuing Operations. Net income from continuing operations for the nine months ended January 28, 2017 was \$112.4 million, compared to \$120.1 million for the nine months ended January 30, 2016. Earnings per diluted share from continuing operations were \$1.17 in the current period compared to \$1.22 in the prior year period. Weighted average diluted shares outstanding in the current period were 95.9 million compared to 98.5 million in the prior year period. The current period cash dividend was \$0.72 per common share compared to \$0.66 in the prior year period.

Discontinued Operations

For the nine months ended January 28, 2017, net loss from discontinued operations was \$3.2 million. For the nine months ended January 30, 2016, net income from discontinued operations was \$1.5 million. The net loss incurred during the nine months ended January 28, 2017 was due to a change in estimate of the tax impact of the sale of Patterson Medical.

LIQUIDITY AND CAPITAL RESOURCES

For the nine months ended January 28, 2017, net cash flows used in operating activities were \$12.6 million, compared to net cash flows used in operating activities of \$86.5 million for the nine months ended January 30, 2016. The use of cash during the nine months ended January 28, 2017 was primarily a result of investments in inventory to support our enterprise resource planning implementation to maintain service levels.

For the nine months ended January 28, 2017, net cash flows used in investing activities were \$1.6 million, compared to net cash flows used in investing activities of \$399.4 million for the nine months ended January 30, 2016. The prior year period included the purchase of Animal Health International, Inc. for \$1,106.6 million, which was partially offset by the receipt of net cash proceeds from completion of the sale of Patterson Medical in the amount of \$714.4 million. We expect to use a total of \$50 million to \$60 million for capital expenditures in fiscal 2017, with our main investment in our information technology initiatives.

Net cash provided by financing activities for the nine months ended January 28, 2017 was \$4.1 million. Cash proceeds included \$178.0 million attributed to draws on our revolving line of credit. Uses of cash from financing activities consisted primarily of \$84.7 million for share repurchases and \$70.9 million for dividend payments. For the nine months ended January 30, 2016, cash provided by financing activities was \$246.7 million. Cash proceeds included \$988.4 million of net proceeds from the issuance of long-term debt and \$198.0 million attributed to draws on our

revolving line of credit. Uses of cash from financing activities were as follows: \$678.3 million for the retirement of long-term debt, \$200.0 million for share repurchases and \$67.0 million used to fund dividend payments.

Table of Contents

During fiscal 2016, we entered into a credit agreement (the "Credit Agreement"), under which the lenders provided us with senior unsecured lending facilities of up to \$1.5 billion, consisting of a \$1.0 billion unsecured term loan and a \$500 million unsecured revolving line of credit. The Credit Agreement was due to expire in fiscal 2021.

In the third quarter of fiscal 2017, we entered into an amendment of the Credit Agreement (the "Amended Credit Agreement"), consisting of a \$295.1 million term loan and a \$750 million revolving line of credit. Interest on borrowings is variable and is determined as a base rate plus a spread. This spread, as well as a commitment fee on the unused portion of the facility, is based on our leverage ratio, as defined in the Amended Credit Agreement. The term loan and revolving credit facilities will mature no later than January 2022.

As of January 28, 2017, \$295.1 million of the Amended Credit Agreement unsecured term loan was outstanding at an interest rate of 2.27%, and \$198.0 million was outstanding under the Amended Credit Agreement revolving line of credit at an interest rate of 2.22%. At April 30, 2016, \$317.6 million was outstanding under the Credit Agreement unsecured term loan at an interest rate of 1.81%, and \$20.0 million was outstanding under the Credit Agreement revolving line of credit at an interest rate of 3.88%.

We expect funds generated from operations, existing cash balances and credit availability under existing debt facilities will be sufficient to meet our working capital needs and to finance anticipated expansion plans and strategic initiatives over the remainder of fiscal 2017.

OUTLOOK

We believe certain strategic decisions and external market factors will have an effect on our results of operations for at least the remainder of fiscal 2017. We believe that softness in the U.S. dental market, along with our decision to not extend our exclusive relationship with Sirona for its full portfolio of products and a realignment of our sales force will have a negative effect on sales. We believe we will continue to experience pricing pressure from branded pharmaceutical manufacturers in our Animal Health segment, which will negatively impact gross margins. Finally, we expect to incur increased operating expenses associated with our ERP system initiatives. While these strategic decisions and external market factors are expected to impact our near-term performance, we believe that we are making the right strategic moves to facilitate growth in our two key operating businesses.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note 1 to the Condensed Consolidated Financial Statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk consisting of foreign currency rate fluctuations and changes in interest rates.

We are exposed to foreign currency exchange rate fluctuations in our operating statement due to transactions denominated primarily in Canadian Dollars and British Pounds. Although we are not currently involved with foreign currency hedge contracts, we continually evaluate our foreign currency exchange rate risk and the different mechanisms for use in managing such risk. A hypothetical 10% change in the value of the U.S. dollar in relation to our most significant foreign currency exposures would have changed net sales by approximately \$59 million for the nine months ended January 28, 2017. This amount is not indicative of the hypothetical net earnings impact due to the partially offsetting impact of the currency exchange movements on cost of sales and operating expenses. We estimate that if foreign currency exchange rates changed by 10%, the impact would have been approximately \$2 million to earnings before income taxes for the nine months ended January 28, 2017.

During fiscal 2016, we entered into the Credit Agreement under which the lenders provided us with senior unsecured lending facilities of up to \$1.5 billion, consisting of a \$1.0 billion unsecured term loan and a \$500 million unsecured revolving line of credit, which was due to expire in fiscal 2021. In the third quarter of fiscal 2017, we entered into an amendment of the Credit Agreement (the "Amended Credit Agreement"), consisting of a \$295.1 million term loan and a \$750 million revolving line of credit. Interest on borrowings under the Amended Credit Agreement is variable. Due to the interest rate being variable, fluctuations in interest rates may impact our earnings. Based on our current level of debt, we estimate that a 100 basis point change in interest rates would have a \$4.9 million annual impact on our net

income from continuing operations before taxes.

Our earnings are also affected by fluctuations in short-term interest rates through the investment of cash balances and the practice of selling fixed rate equipment finance contracts under agreements with both a commercial paper conduit and a bank that provide for pricing based on variable interest rates.

19

Table of Contents

When considering the exposure under the agreements whereby we sell equipment finance contracts to both a commercial paper conduit and bank, we have the ability to select pricing based on interest rates ranging from 30 day LIBOR up to twelve month LIBOR. In addition, the majority of the portfolio of installment contracts generally turns over in less than 48 months, and we can adjust the rate we charge on new customer contracts at any time. Therefore, in times where the interest rate markets are not rapidly increasing or decreasing, the average interest rate in the portfolio generally moves with the interest rate markets and thus would parallel the underlying interest rate movement of the pricing built into the sale agreements. In calculating the gain on the contract sales, we use an interest rate curve that approximates the maturity period of the then-outstanding contracts. If increases in the interest rate markets occur, the average interest rate in our contract portfolio may not increase at the same rate, resulting in a reduction of gain on the contracts sales as compared to the gain that would be realized if the average interest rate in our portfolio were to increase at a more similar rate to the interest rate markets. We estimate that a 10% change in interest rates would have an approximate \$1 million annual impact on our net income from continuing operations before taxes.

For further information on market risk, refer to Item 7A in our 2016 Annual Report on Form 10-K filed June 29, 2016.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our President and Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"), management evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of January 28, 2017. Based upon their evaluation of these disclosure controls and procedures, the CEO and CFO concluded that the disclosure controls and procedures were effective as of January 28, 2017.

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act) that occurred during the quarter ended January 28, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

On June 16, 2015, we acquired Animal Health International, Inc., which was a privately-held company prior to the acquisition. We are in the process of integrating Animal Health International, Inc.'s operations, and as permitted under SEC regulations, we excluded the operations of Animal Health International, Inc. from the scope of our Sarbanes-Oxley Section 404 report on internal control over financial reporting for the fiscal year ended April 30, 2016. We are in the process of evaluating Animal Health International, Inc.'s internal controls and implementing our internal control structure over the acquired operations, and we expect to complete this effort during fiscal 2017.

Table of Contents

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In September 2015, we were served with a summons and complaint in an action commenced in the U.S. District Court for the Eastern District of New York, entitled SourceOne Dental, Inc. v. Patterson Companies, Inc., Henry Schein, Inc. and Benco Dental Supply Company, Civil Action No. 15-cv-05440-JMA-GRB. SourceOne, as plaintiff, alleges that, through its website, it markets and sells dental supplies and equipment to dentists. SourceOne alleges in the complaint, among other things, that we, along with the defendants Henry Schein and Benco, conspired to eliminate plaintiff as a competitor and to exclude them from the market for the marketing, distribution and sale of dental supplies and equipment in the U.S. and that defendants unlawfully agreed with one another to boycott dentists, manufacturers, and state dental associations that deal with, or considered dealing with, plaintiff. Plaintiff asserts the following claims: (i) unreasonable restraint of trade in violation of state and federal antitrust laws; (ii) tortious interference with prospective business relations; (iii) civil conspiracy; and (iv) aiding and abetting the other defendants' ongoing tortious and anticompetitive conduct. Plaintiff seeks equitable relief, compensatory and treble damages, jointly and severally, punitive damages, interest, and reasonable costs and expenses, including attorneys' fees and expert fees. We are vigorously defending ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial condition.

Beginning in January 2016, purported class action complaints were filed against defendants Henry Schein, Inc., Benco Dental Supply Co. and Patterson Companies, Inc. Although there were factual and legal variations among these complaints, each alleged that defendants conspired to foreclose and exclude competitors by boycotting manufacturers, state dental associations, and others that deal with defendants' competitors. On February 9, 2016, the U.S. District Court for the Eastern District of New York ordered all of these actions, and all other actions filed thereafter asserting substantially similar claims against defendants, consolidated for pre-trial purposes. On February 26, 2016, a consolidated class action complaint was filed by Arnell Prato, D.D.S., P.L.L.C., d/b/a Down to Earth Dental, Evolution Dental Sciences, LLC, Howard M. May, DDS, P.C., Casey Nelson, D.D.S., Jim Peck, D.D.S., Bernard W. Kurek, D.M.D., Larchmont Dental Associates, P.C., and Keith Schwartz, D.M.D., P.A. (collectively, the "putative class representatives") in the U.S. District Court for the Eastern District of New York, entitled In re Dental Supplies Antitrust Litigation, Civil Action No. 1:16-CV-00696-BMC-GRB. Burkhardt Dental Supply Company, Inc. was added as a defendant on October 22, 2016. Subject to certain exclusions, the putative class representatives seek to represent all persons who purchased dental supplies or equipment in the U.S. directly from any of the defendants, since August 31, 2008. In the consolidated class action complaint, putative class representatives allege a nationwide agreement among Henry Schein, Benco, Patterson and Burkhardt not to compete on price. The consolidated class action complaint asserts a single count under Section 1 of the Sherman Act, and seeks equitable relief, compensatory and treble damages, jointly and severally, interest, and reasonable costs and expenses, including attorneys' fees and expert fees. Putative class representatives have not specified a damage amount in their complaint. While the outcome of litigation is inherently uncertain, we believe the consolidated class action complaint is without merit, and we are vigorously defending ourselves in this litigation.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On March 19, 2013, our Board of Directors approved a share repurchase plan that replaced a previously existing share repurchase plan. Under the March 19, 2013 plan, up to 25 million shares may be purchased in open market transactions through March 19, 2018.

The following table presents activity under the stock repurchase plan during the third quarter of fiscal 2017:

Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced	Maximum Number of Shares That May Yet Be Purchased Under
--	------------------------------------	--	--

			Plans or Programs	the Plan
October 30, 2016 to November 26, 2016	25,790	\$ 38.76	25,790	15,396,854
November 27, 2016 to December 24, 2016	486,735	39.85	486,735	14,910,119
December 25, 2016 to January 28, 2017	399,078	41.37	399,078	14,511,041
	911,603	\$ 40.48	911,603	14,511,041

Table of Contents

During fiscal 2016, we entered into a credit agreement (the "Credit Agreement"), under which the lenders provided us with senior unsecured lending facilities of up to \$1.5 billion, consisting of a \$1.0 billion unsecured term loan and a \$500 million unsecured revolving line of credit. The Credit Agreement was due to expire in fiscal 2021. In the third quarter of fiscal 2017, we entered into an amendment of the Credit Agreement (the "Amended Credit Agreement"), consisting of a \$295.1 million term loan and a \$750 million revolving line of credit. The Amended Credit Agreement permits us to declare and pay dividends, and repurchase shares, provided that no default or unmatured default exists and that we are in compliance with applicable financial covenants.

ITEM 6. EXHIBITS

The exhibits listed in the accompanying Exhibit Index are filed as part of this Quarterly Report on Form 10-Q. All other items under Part II have been omitted because they are inapplicable or the answers are negative, or were previously reported in the 2016 Annual Report on Form 10-K filed June 29, 2016.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PATTERSON COMPANIES, INC.
(Registrant)

Dated: March 8, 2017

By: /s/ Ann B. Gugino
Ann B. Gugino
Executive Vice President, Chief Financial Officer and Treasurer
(Principal Financial Officer and Principal Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit
No. Exhibit Description

- 10.1 Amended & Restated Credit Agreement among Patterson Companies, Inc., The Bank of Tokyo-Mitsubishi UFJ, Ltd., as agent, and the lenders party thereto, dated January 27, 2017 (incorporated by reference to our Current Report on Form 8-K, filed January 27, 2017 (File No. 000-20572)).
- 31.1 Certification of the Chief Executive Officer pursuant to Rules 13a-4(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-4(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Financials in XBRL format.