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XRAY - Q3 2014 DENTSPLY International Inc Earnings Call

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OVERVIEW:

Co. reported 3Q14 as-reported net income attributable to Co. of $75.3m or $0.52 per diluted share. Expects adjusted EPS to be $2.49-2.53.

CORPORATE PARTICIPANTS

Derek Leckow *DENTSPLY International Incorporated - VP of IR*

Bret Wise *DENTSPLY International Incorporated - Chairman & CEO*

Jim Mosch *DENTSPLY International Incorporated - EVP & COO*

Chris Clark *DENTSPLY International Incorporated - President & CFO*

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Brandon Couillard *Jefferies & Company - Analyst*

Nathan Rich *Goldman Sachs - Analyst*

Ravi Fadah *William Blair & Company - Analyst*

Erin Wilson *BofA Merrill Lynch - Analyst*

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Jon Block *Stifel Nicolaus - Analyst*

PRESENTATION

Operator

Good day and welcome to the Dentsply International third-quarter 2014 earnings call. Today's conference is being recorded. At this time, I'd like to turn the call over to Mr. Derek Leckow, Vice President of Investor Relations. Sir, you may begin.

Derek Leckow - *DENTSPLY International Incorporated - VP of IR*

Thank you, Devona. Good morning everyone. Thank you for joining us to discuss Dentsply International's third-quarter 2014 results.

I'm joined by Bret Wise, Dentsply's Chairman and Chief Executive Officer; Chris Clark, our President and Chief Financial Officer; and Jim Mosch, our Executive Vice President and Chief Operating Officer. I hope you had a chance to review our press release issued earlier this morning. I'd like to point out that a copy of the release and a set of supplemental slides and information relating to non-GAAP financials are available for download in the Investor Relations section of our website, www.dentsply.com, under the heading Events and Presentations.

I'd like to remind everyone that the Safe Harbor language and US GAAP reconciliation contained in today's press release also pertain to this conference call. We may make forward-looking statements involving risks and uncertainties. These should be considered in conjunction with the risk factors and uncertainties that are described in the release and in our SEC filings. It is possible that actual results may differ materially from the forward-looking statements that we make today. The Company undertakes no obligation to update or revise any forward-looking statements to reflect events or circumstances that may arise after the date of this call.

A recording of this call in its entirety will be available on our website. And with that, I'd now like to turn the call over to Bret Wise. Bret?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

All right. Thank you, Derek. Good morning everyone. Thank you again for joining us. I'm going to start with a few observations on the market and on our own performance and then hand it off to Jim and Chris for more details.

So starting with the markets. Overall, we would say that the global dental consumable markets are stable. Not accelerating a lot at this point but also with a few notable exceptions; no real slowing. US market is showing some signs of life, particularly in chairside consumables which may be picking up a bit. That's important because this is a very large category with many industry participants and frankly, it's an area where we're having a very good year.

In Europe, Q3 is, of course, a tough benchmark because of the summer holiday period. It tends to be a one-month quarter. But we would say that generally, we've seen some slight improvements with notable exception of CIS region; Russia and Ukraine are still quite negative. But ex-CIS, we saw modest improvements across a broad range of countries and a broad range of products throughout Europe. So this was a broader improvement than we've seen for some time in Europe. We realize this is a bit contrary to the recent economic news coming out of the region so it's not clear whether this is indicative of a broader market trend or it's simply an improvement on our performance over this period of time.

Rest of World continues to be a mixed bag. Looks pretty strong in Asia and the Middle East. Australia seemed to be better despite a significant weakening of their currency while Brazil remained slow and Japan remained modestly negative, I think still suffering a bit from the excise tax hangover that occurred in March. But overall, we would say there's no big news in the market conditions, one way or the other. Pretty stable conditions throughout the globe.

For our own performance, internal growth picked up a bit in the quarter. We were up 2.4% and we were positive in all the US, Europe and Rest of World. Overall, we had sales growth ex-PM of positive 1.8%. That was held mostly by the internal growth, which I mentioned was 2.4% positive and acquisitions added a modest 0.6%. Constant currency was 3% in the quarter. Currency translation was more negative than when we entered the quarter. We ended up down 1.2% because of currency and so constant currency 3%; negative currency 1.2% yields to 1.8% growth. Internal growth was a positive 2% in the US; was positive 1% in Europe and interestingly, it was up 2.4% without CIS and Europe. So that's -- as I mentioned, that's a pretty notable improvement.

Internal growth in Rest of World regions was positive 5.9%; that was led by strong performance in the emerging market countries. Growth by category and these are global categories was strongest in the chairside consumables followed by the dental specialties and medical while lab continued to be slightly negative, driven by weakness in Europe. On operational execution, we continued to implement changes to improve our margins and a slow growth environment. We saw good margin expansion for the third quarter running. We were up 80 basis points this quarter and at this point, we're also up 80 basis points in the year to date area so pretty consistent margin improvement throughout the year.

This gives us an adjusted EPS growth of just under 9% in the quarter which is up nicely against a 12% EPS growth; that's adjusted EPS growth in the third quarter last year. So we were up against a reasonably tough base period. Adjusted EPS is also up 8.5% to 9% in -- for the year to date, so through nine months. When we entered the year, we had stated that margin expansion and improving asset turns were important objectives for this year while continuing to invest in future growth initiatives.

I think the margin expansion that we see here is good evidence that we're making, I think, strong progress on margins while asset management has also been quite strong with operating cash flows growing close to 40% year to date. So we are pleased with these results given the low growth environment. We believe the actions we're taking today will facilitate stronger earnings growth, even in a low growth environment like we're in today, but much higher earnings growth when markets return to more normal growth rates.

We're moving forward on a number of fronts to improve the operational execution. This quarter, we announced that we are in talks with the Works Council in Germany to improve the performance of the European Lab business. This initiative will become more clearer over the next couple of quarters based on the progression of those discussions. Another area of emphasis is consolidating or reducing certain product lines and eliminating SKUs where it's optimal to our operating performance. This will likely result in our discontinuing some low-margin product lines but also will result in improved asset turns and return on invested capital. We'll update you more on that as we move through the fourth quarter here and into next year.

Of course, with the strong cash flow comes improvements in our balance sheet, giving us more flexibility for internal investments, for external investments such as acquisitions and also returning cash to shareholders via share repurchases and dividends and Chris is going to speak more to that. So as we execute three, we're updating our earnings guidance for the full year to adjusted EPS of $2.49 to $2.53. We have some very good opportunities but also some significant currency and tax headwinds in the fourth quarter and also some cost headwinds based on reinvestment plans that we have. Chris will give you more on that in a moment.

As far as 2015, we're going to defer discussing or giving guidance on 2015 until we report our fourth quarter and the full-year results and that's the normal schedule that we follow. So we'll give that to you in February. So that concludes my prepared remarks. I'm going to turn the call over to Jim now for some operational comments.

Jim Mosch - *DENTSPLY International Incorporated - EVP & COO*

Thank you, Bret. I'd like to provide a brief perspective on a few operational items and then turn it over to Chris for the financial review.

As indicated previously, we have undertaken several initiatives to improve our operating performance. In September, we announced that we had proposed steps to reorganize elements of our German Laboratory Business and the associated manufacturing capabilities. We are seeking to realign our portfolio of laboratory products with increased focus on innovative prosthetic materials while deemphasizing the CAD/CAM equipment business. As required under German law, the company has entered into a statutory co-determination process with the appropriate labor groups.

Last quarter, we outlined the consolidation of our Rinn and Sultan divisions into Dentsply Professional based in York, Pennsylvania. Our objective was twofold: first, to create a global preventive and infection control business, and second, to drive operating efficiencies. In October, this consolidation was completed. Operations have been transferred and the new structure is now operational. It's important to note that on a year-to-date basis, both of these businesses are growing above market, both Sultan and Rinn. And the Rinn business, in particular, has benefited from additional sales focus from the Professional division.

This is important given that as we go through a restructuring, that we maintain topline growth. In addition to the above, we have also launched a global strategic sourcing initiative. We recognize that given the nature of our global business with multiple manufacturing facilities and distribution locations, we have created a complex supply chain environment. While we're at the very early stages, we believe that there are significant opportunities for improvement in both asset management and cost reduction.

Turning to the performance of our business groups, we are pleased with the performance of our Consumables business specific to restoratives and preventive and infection control portfolios. In both portfolios, we are growing above market and increasing market share. Restoratives has benefited from a string of new products, such as TPH Spectra, Aquasil Cordless, Prime&Bond Elect, and SmartLite. These products, in combination with the market-leading SDR bulk-fill composite and the Palodent Plus Matrix System, has supported an innovative marketing campaign focused on Class II restorations, one of the most common used procedures of dentistry. This has resonated positively with the clinicians.

Similarly, our preventive and infection control business has also grown by entering new categories, with products such as NUPRO Fluoride Varnish and NUPRO Freedom Cordless Prophy System and the expanding of leading brand portfolio, such as Cavitron and Sultan.

Our Lab business has been challenged after a decade-long decline of the precious metal alloys. Although this decline has slowed and may be near bottom. With this, we see some good opportunities to meet the needs of our lab customers by improving our traditional lab portfolio and providing a broader suite of next-generation materials and digital services that help our customers to perform their work more efficiently and better outcomes for the end customers and their patients.

Turning to our Implant business, it has improved sequentially as competency and effectiveness continues to improve at the field level. In the quarter, Implants grew mid-single digits on a constant currency basis, in line with the overall implant market. Growth has been driven by the launch of the Astra Tech EV Implant System and double-digit growth of our digital implant portfolio. In the quarter, we saw all three regions: US, Europe and Rest of World show growth in our Implant business. We anticipate that EV will continue to fuel growth as we further penetrate the larger markets. To date, the feedback has been very positive and the conversion rate is greater than anticipated. In addition, one-third of the conversions are coming from new customers.

In regards to new products, our Midwest division, which markets and manufactures high and low speed dental handpieces and dental burs launched the Midwest E Electric Handpiece at the recent ADA. The new Electric Handpiece has several unique features which allow our Midwest business to compete in the important and growing electric handpiece segment. This is a category where we have not been competitive in a meaningful way historically so we believe there is a good potential for this product line addition. While the Midwest business is a market leader in dental handpiece and the bur business in North America, it is not widely marketed outside this region. With the earlier launch of the Midwest Automate Handpiece Maintenance Station and now Midwest E, we plan to further develop Midwest into a global business.

As we enter Q4, we will launch several new products. First is TRUSHAPE, a new endodontic file system, which is a shape-adjusting file that preserve dentin and supports the emerging trend of minimally invasive dentistry. This is a new approach in endodontic and as the market leader, we believe we are well-positioned to demonstrate its clinical effectiveness. Second, we have launched a new guided surgery kit for the Astra Tech EV Implant System. This is based off our market-leading XiVE implant guided surgery system and will further support the launch of the Astra Tech EV Implant System.

And finally, Miyabi. Miyabi is a high-strength composite intended for the fabrication of anterior crowns. This is an additional indication of the potential for innovation in non-metal crown and bridge materials which is a key focus of our Prosthetics business. Miyabi has been recently approved for the Japanese public market and is in launch with excellent acceptance.

I'd now like to turn it over to Chris Clark for the financial reviews.

Chris Clark - *DENTSPLY International Incorporated - President & CFO*

Thank you Jim. Good morning, everyone.

I'd like to provide some detail on our financial performance for the third quarter, including our efforts to improve operating margin, cash flow and asset utilization. As Bret mentioned, internal sales growth in the quarter accelerated from the levels we saw in Q2, both globally and in all three major geographic regions, with the US growth particularly notable given the plus -- positive 4.3% growth in baseline in last year's third quarter. Our results included combined headwinds of about 75 basis points from a discontinued non-core, non-dental product in the US that was in-sourced by a customer, and also from ongoing headwinds from Russia CIS.

Consistent with previous years, we implemented price increases across many of our businesses effective October 1. We estimate the pricing impact to be generally similar to previous years although in a lower interest rate environment, we believe customers may have pulled forward a modest level of incremental purchases in advance of the pricing change. While it's difficult to quantify, we estimate this impact to have been approximately 40 to 50 basis points in sales growth in the quarter.

Gross profit rate on an adjusted basis in the quarter was 57.7% of sales excluding precious metals, which represented an improvement of 110 basis points over last year's third quarter. The impact here is primarily favorable price and mix effects in the period. SG&A expenses, on an adjusted basis were 39.1% of sales excluding precious metals. This was 40 basis points above our run rate in Q3 2013 and reflects increased professional services spending in the quarter.

Operating margin for the quarter improved 80 basis points to 18.7% of sales excluding precious metals on an adjusted basis. That compares to 17.9% in the third quarter last year. I would add that currency was a slight headwind to operating margin in the quarter. We continue to be pleased with our operating margin improvement, as adjusted operating margin for the first nine months of 2014 is up by 80 basis points over prior year despite a 30 basis point headwind from currency over that period.

We believe that we are solidly on track towards our objective of reaching a 20% adjusted operating margin rate in 2017 and believe our margin improvement strategies are gaining traction. Jim spoke to a number of the initiatives here so I won't repeat those, but I do want to comment that while we're on -- while progress towards the 20% goal will not be linear, we're very much on track against the objective and we'll continue to provide perspective on key events and strategies as we move forward.

Our reported tax rate for the third quarter was 21.8% and our operating tax rate was 22.8% for the quarter. As anticipated, tax represented a bit of a headwind in the quarter as the operating tax rate was 70 basis points above our 22.1% rate in the third quarter last year. Year to date, our operating tax rate of 22.6% is a 60 -- 50 basis point headwind to last year's rate. That's consistent with the guidance we provided for the year. I should also note that this is also consistent with what we expect for the operating tax rate from the fourth quarter, which will be a negative comparison to last year's fourth-quarter operating tax rate by about 180 basis points.

Net income attributable to Dentsply International on an as reported basis in the third quarter was $75.3 million, or $0.52 per diluted share, and that compares to $79.9 million, or $0.55 per diluted share in the third quarter of 2013. These results include a number of items which we've listed in the schedules in the press release. On an adjusted basis, net earnings grew to $89.3 million from $82.2 million in the prior-year quarter. And adjusted diluted earnings per share grew 8.8% to $0.62 per diluted share compared to $0.57 per diluted share in the third quarter last year.

While we commented on the Q2 earnings call that then current rates would have minimal impact on earnings for the second half of the year, exchange rates moved against us as the quarter progressed, with the strengthening of the US dollar against the euro being particularly acute. As a result, earnings in the third quarter were negatively impacted by currency by approximately $0.01 per share. While rates are highly volatile at present, we anticipate currency being a headwind at fourth-quarter earnings by about $0.02 per share as we enter the quarter with a euro rate that was 7% weaker versus the US dollar compared to the prior year.

Moving on to cash flow, our operating cash flow for the quarter was $147.5 million, which represents a 17% increase over last year's $126.5 million. This represents a record third-quarter cash flow performance for the Company as our third straight quarterly record. For the first nine months of 2014, our operating cash flow of $367.8 million represents an increase of $109.5 million over prior year, which is a 42% increase. Our free cash flow yield has increased to well above 6% on a trailing 12-month basis. We continue to focus on driving better cash conversion and while we're pleased with the progress, we continue to see opportunities to improve even further moving forward as we continue to drive working capital improvements.

With respect to working capital, I had commented previously that after strategically increasing inventories for several quarters to support anticipated operational changes, we anticipated that inventories would start to decline in the second half of the year and then gradually return to more normal levels. We are executing to that plan, as the inventories dropped by 4 days sequentially in the quarter and now stand at 119 days on a constant currency basis compared to 123 days at the end of June and 118 days last September. Accounts receivable days were 62 days at the end of September, down 2 days from last year and up 3 days sequentially.

Capital expenditures were $24 million in the quarter while depreciation was $21 million and amortization was $13 million. We anticipate CapEx to be approximately $110 million for the year and this reflects incremental investments and initiatives to support our 20% operating margin goal, including continued investment in our common ERP platform initiatives. Net debt improved by over $117 million in the quarter and our net debt to capitalization ratio now stands at 32.2% compared to 35.8% a year ago and 48.2% right after the Astra Tech acquisition.

Given our rapid deleveraging and strong cash flow, we view capital deployment as a catalyst moving forward, with focus on reinvestment in growth initiatives, acquisitions and share repurchases. We remain highly engaged on the acquisition front and continue to see opportunities to strengthen the business through M&A. From a share repurchase standpoint, the Company repurchased approximately 345,000 shares of common stock in the quarter. That brings our year-to-date total to approximately 1.5 million shares. Through September we have returned almost $100 million to shareholders through dividends and share buybacks. And as I mentioned, we continue to see capital deployment through both M&A and share repurchases as opportunities to accelerate value moving forward.

As we look to the fourth quarter, we're assuming generally similar market trends to what we've experienced recently. We're also anticipating comparative headwinds of approximately $0.05 per share as a result of the currency impact I mentioned previously; a modest contraction in channel inventories as a result of purchases ahead of the October price increase; incremental investments to support our operating margin improvement initiative; and also the continued year-on-year headwind and our operating tax rate that actually increases in the fourth quarter. Based on these factors, we're narrowing our adjusted earnings per share guidance to a range of $2.49 to $2.53 for the year.

That completes our prepared remarks. We certainly appreciate your support and we'd be glad to take any questions you might have.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Brandon Couillard, Jefferies.

Brandon Couillard - *Jefferies & Company - Analyst*

Thanks. Good morning.

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

Good morning.

Brandon Couillard - *Jefferies & Company - Analyst*

Bret, in terms of the organic revenue growth acceleration in the quarter, can you speak to the improvements on a sequential basis? Exactly what change -- to go from a modest decline in Q2 to up about 2.4% in the third quarter? Could you speak to any variability you saw month to month through the period and particularly how you, I guess, exited the quarter, especially in the US?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

Sure. Brandon, I'll take a shot at that. The improvements we saw were pretty broad across the spectrum of both countries and products. Europe, in particular, was broad. I mentioned that in my prepared remarks.

If I had to point a finger at things that have improved from a product category basis, it would be the chairside consumables. Have been strong for us but continue to be particularly strong for us in the third quarter.

We saw our performance in implants improve in the third quarter and again, on a regional basis, we saw Europe improve pretty notably during the quarter. So that's a couple items. I'd also say that things that were dragging our performance became less of a drag in the third quarter as well.

As far as improvements throughout the quarter, I'm going to tell you that September was by far the best. But the third quarter, particularly in Europe, is a one-month quarter. September is basically all you get. And in this September, there was an extra selling day. We were short a selling day in August but we had an extra selling day in September so we would have expected it to be strong.

With respect to the US market, I don't know that I saw a huge variance throughout the quarter so I would say we exited the quarter at about a pace that we saw throughout the quarter, not notably stronger or weaker. Chris and Jim, do you have anything to add to that?

Chris Clark - *DENTSPLY International Incorporated - President & CFO*

I think that's accurate.

Brandon Couillard - *Jefferies & Company - Analyst*

Thanks. Chris, I guess a two-part question for you. First, on the working capital front. Could you speak to what you perceive as the incremental near-term opportunity on the inventory so should we be expect those levels to decline on an absolute basis over the coming quarters?

And then secondly, without getting into guidance for next year but just to give us a benchmark, at current rates, could you quantify what the EPS headwind would be from currency in 2015 for us?

Chris Clark - *DENTSPLY International Incorporated - President & CFO*

Okay. I'll certainly take a stab at both of those. Relative to working capital and specifically inventory, we commented previously, Brandon, that we had increased strategically inventories in advance of some operational changes. And we anticipated in the second half of 2014 for that to begin to gradually come down and continue to come down in 2015.

Again, as I commented, I think we're very much on that plan. We came down four days sequentially in the third quarter. We're pleased with that.

We would anticipate some continued progress in the fourth quarter. Typically, our phasing in terms of inventories through the year typically has us increasing inventory slightly in the first half of the year and then bringing it down.

But again, I think four days coming down in the quarter is pretty strong for us. So as we look at it, I would anticipate Q4 continuing to come down a bit. And as we look to next year, I think we'll continue to come down. We may not come down quite as sequentially or quite to that same degree at that same rate, but we're sitting at 119 days which gives us a significant opportunity yet to bring this down to a far more reasonable number.

Regarding FX, I'm not going to quantify what the FX headwind would be for next year, but obviously as we enter Q4, we see a pretty significant strengthening of the US dollar against a number of factors -- a number of other currencies, I mean. Against the Euro, we're basically -- we came in the quarter about 7% stronger in terms of the dollar against the Euro. That's pretty consistent among other major currencies.

Obviously, we have a cash flow hedging program in place that helps to moderate that, if you will, or gradualize that but there's no doubt that in general, a weaker dollar is certainly helpful for us relative to the stronger dollar. We'll provide more flavor on that as we get into -- if the rates stay where they are, in any case, wherever the rates are, we'll provide more flavor on that in the call in February.

Brandon Couillard - *Jefferies & Company - Analyst*

Super. Thank you.

Chris Clark - *DENTSPLY International Incorporated - President & CFO*

You bet.

Operator

Robert Jones, Goldman Sachs.

Nathan Rich - *Goldman Sachs - Analyst*

Hi, this is Nathan Rich on for Bob today. First, if I could just ask on the performance you saw in implants in the quarter; definitely better than we've seen for the last several quarters. I'd just be curious to get your thoughts on how much of the improvement might have been tied to just stronger growth in the overall implant market versus what was maybe related to share gains that came with the launch of the Astra Tech EB System?

Jim Mosch - *DENTSPLY International Incorporated - EVP & COO*

Nathan, this is Jim Mosch. I would say that when we look at the overall implant market, we believe that's growing at mid-single digit levels. We feel that we're in alignment with that. The performance in the various markets; obviously, as CIS continues to be a very significant drag, we saw improvement in Europe, ex-CIS, probably at the best level we've seen since the acquisition.

We actually would like to think that, that's a little bit better than in market within Europe. As far as the rest of the geographies, I think we felt that we were pretty much in line with that; could be a little bit stronger in North America.

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

I'd add to that, Nathan, that the EB launch really took hold with full inventory in September for us in North America so we're just getting into that.

Jim Mosch - *DENTSPLY International Incorporated - EVP & COO*

Absolutely.

Nathan Rich - *Goldman Sachs - Analyst*

That's great to hear so it seems like there's more opportunity there. So if I could shift gears to the efficiency initiatives that you're working on and the margin expansion that you've seen,

I just was curious to get your thoughts on -- does that allow you to invest in your competitive positioning in the market and try and go after share more aggressively? And just maybe overall, your thoughts on investing some of these savings back into the business?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

That's a great question, Nathan, and the program is designed to take cost out and certain elements of the business and reinvest those costs or a portion of those savings in variable spending for growth. So we are now and we will be, as we move through the next two years on the margin expansion program, redirecting some of the savings and the margin target is a net target. It's net of the reinvestments.

But we'll be reinvesting some of those savings in four or five areas that we think can facilitate stronger growth going forward. That is part of the program.

Nathan Rich - *Goldman Sachs - Analyst*

Great. Thanks for the questions.

Operator

John Kreger, William Blair.

Ravi Fadah - *William Blair & Company - Analyst*

Hi, good morning guys. It's Ravi Fadah in for John today. Thanks for taking the questions. Morning. You mentioned implants a few times. How did the other specialties fare, Endo or Ortho, in the quarter?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

It's -- I'd say it's a mixed bag. Endo, quite well. We've got a full bag of innovation both that's been launched in Endo and that's coming so we're quite optimistic about that business.

Ortho is a business that's under repair from us still and we've commented on these calls before and I think it's still true that, that's an area where competition is just really fierce, meaning there's a lot of discounting, a lot of packaged deals, people trying to load up customers, et cetera. Probably the most competitive area of dentistry right now and the one area that I would say it's under price pressure. Those circumstances continue from what we commented on over the last couple of quarters.

Ravi Fadah - *William Blair & Company - Analyst*

Got it. Thanks. How far along are you in the process of regaining some of those clients that you lost a few years back?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

Jim, do you want to take that?

Jim Mosch - *DENTSPLY International Incorporated - EVP & COO*

Absolutely. Ravi, we've consistently worked over the last couple of quarters on regaining those customers. I think, as Bret has described, it has been somewhat of a dog fight. We believe that we got the initial two-thirds back pretty quickly.

Obviously, capacity has increased in the market. The price pressure is there. Market indications may be that case starts are probably flat at best. So it's a very challenging market environment.

I think we are putting programs in place. We are making investments in the field organization and we are actively working to regain those customers.

Chris Clark - *DENTSPLY International Incorporated - President & CFO*

I might add, I think we commented earlier that -- or previously that we're managing this business for customer count at this stage. So again, we're very, very focused on what basically an account by account war or battle, if you will, and again, obviously, competition is making -- doing what they can to keep those accounts as well.

Ravi Fadah - *William Blair & Company - Analyst*

Great. One more if I could. You mentioned in your prepared remarks that there would be some discontinued products over the next couple of quarters. Will we see an impact to the top line from those or is it -- will it be too small to notice?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

It depends on timing and in part, this is subject to what we're doing with the Lab business in Europe so that's subject to the discussions with the Works Councils. To the extent it's significant, we'll call it out for you. I don't expect it to be material to the Company in any way, probably some trimming around the edges but if any one period, it is notable, then we'll comment on it for you.

Ravi Fadah - *William Blair & Company - Analyst*

Great. Thanks very much.

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

You bet.

Operator

Erin Wilson, Bank of America.

Erin Wilson - *BofA Merrill Lynch - Analyst*

Thanks so much. Can you just go over what are the next immediate steps to your cost-savings initiatives that you've laid out. Sounds like you're progressing according to plan but has anything surprised you there? And can you quantify how much were incremental costs associated with those initiatives that may have offset some of the profit margin improvement in the quarter as well as what's embedded in the guidance for the fourth quarter?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

Okay, Erin, those are good questions. I'm going to start by talking about the initiative itself and I'm let Chris address the impact in the second and third quarters and the impact we expect in the fourth quarter.

The program is pretty broad. It's designed to take advantage of the global footprint we have, become as efficient as we can and then redirect resources out to growth areas in the business model. The areas that we've commented on are thus far are procurement initiative and that's well underway, that's an area actually that we're investing in right now.

We've talked about consolidation of certain business units, Jim mentioned those in his remarks, those are important. We've had a total of three manufacturing facilities be consolidated since we initiated the program.

I don't want to get into forward-looking statements on the program at this point because in part, where this program goes will be subject to things like discussions with the Works Council that we've mentioned in Germany so far. But I think from a broad perspective, it's based on -- and we'll see savings in both the gross margin line and the SG&A and the reinvestment will probably be more in the SG&A line. So Chris, do you have anything --?

Chris Clark - *DENTSPLY International Incorporated - President & CFO*

In terms of the external costs, if you will, the incremental costs associated with program, you should think of it probably in terms of about $0.005 headwind to the third quarter and probably closer to a full $0.01 in the fourth quarter and that's embedded in the $0.05 collective headwind that I mentioned earlier.

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Erin Wilson - *BofA Merrill Lynch - Analyst*

Okay, great. Can you elaborate on that pull-forward in the quarter that you mentioned that benefited revenue growth? And if that's something that carries forward into the next quarter or how should we think about that dynamic?

Chris Clark - *DENTSPLY International Incorporated - President & CFO*

Erin, this is an annual occurrence, if you will, to a degree in the context of, we go out and many of our businesses have annual price increases October 1. We telegraph those price increases to our distributor partners that basically allows them to make the necessary changes they need to when they're putting the systems relative to their pricing, their catalog, et cetera. That also provides them an opportunity to look at the price increase, to make some buying decisions on their part relative to what they want to pull in, in advance of that.

In a lower interest rate environment, we took -- our price increase overall was pretty similar to normal years, but obviously, in a lower interest rate environment, some dealers may have pulled in a little bit more year on year than they did last year. Again, I don't think this is that significant, but it may be 40 to 50 basis points in terms of the overall growth number in the quarter. Obviously, that would be a temporary impact would then come out in the fourth quarter.

Erin Wilson - *BofA Merrill Lynch - Analyst*

Okay, great. Thank you so much.

Operator

Jeff Johnson, Robert W. Baird.

Jeff Johnson - *Robert W. Baird & Company, Inc. - Analyst*

Yes, thank you. Good morning guys. Most of my questions have been answered at this point but let me circle back to one implant question if I could and then maybe just one quick modeling question. On the implant side, the number obviously above I think what a lot of us were expecting. Was wondering, Bret, if maybe you could give us some EB details by geography.

You said it was more robustly launched in September. I think that's probably a US and maybe a German comment, but where else could we see that launched here in the next 6 to 12 to 18 months? And any comments on when you might be able to get that into Japan?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

Okay, so the time -- let me let Jim deal with the timing issues on that.

Jim Mosch - *DENTSPLY International Incorporated - EVP & COO*

Absolutely, Jeff. From a standpoint of the launch, the majority of our launch impacts have occurred really in Europe. And some of the larger geographies, Germany really started up in force in summer. And then in the United States, we've been managing capacities on this launch.

Conversion process has been very strong. And as a result, we started some of the larger markets fast. So quite frankly, we've seen good growth really from the European markets and then the North American markets, quite frankly, are just getting started. So we expect to see favorable impacts from them over time.

I would say the North American market is challenging. It's a large market. It's heavily referral based. And so as a result, the conversion process can be a little bit more demanding, but we're seeing good uptake from that standpoint.

As it relates to Japan, we're in the very -- obviously, we've gone ahead with the registration process. We don't have a good time frame on that right now. If I had an expectation, I would expect more towards the end of next year --

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Jeff Johnson - *Robert W. Baird & Company, Inc. - Analyst*

Okay, that's helpful.

Jim Mosch - *DENTSPLY International Incorporated - EVP & COO*

At the earliest.

Jeff Johnson - *Robert W. Baird & Company, Inc. - Analyst*

Thanks, Jim. And then on the North American comments, I think even probably Europe, both to a certain extent with EB, we've heard in some of our conversations that there might be some channel abutment issues you're still kind of going through. And obviously, I think some of the implant specialty abutment business may be facing a little bit of pressure in general over the last year.

But generally speaking, have you been dealing with some channel inventory issues there? Are there reasons to believe that over the next quarter or two, if you're already growing back in line with market, that we have a chance to see some above market growth out of your implant business here over the next few quarters?

Jim Mosch - *DENTSPLY International Incorporated - EVP & COO*

I think that's a little hard to predict right at this stage. I would say, on our digital business and our ATLANTIS business is that -- it was in my prepared comments, we still see double-digit growth globally in that business. And we continue to integrate some other portfolios in that business, such as our ISUS product line.

We're seeing some good movement in that portfolio. The abutment issue is probably stronger in the referral-based markets. Because you have a situation where you have general practitioners and labs that obviously have liquidation of abutment inventories. And as those recover, we should see improved growth.

Jeff Johnson - *Robert W. Baird & Company, Inc. - Analyst*

All right, great. And then Chris, just a couple of modeling questions here, real quickly. We talked a little bit about that pull-forward effect that will impact fourth quarter a little bit. It doesn't sound like from Bret's comments, that the product rationalization issues will create much of a headwind going forward, or at least not a sizable one.

How do we think about then as that customer in-sourcing issue comes off? I was interested to hear your lab comments that maybe that business is starting to bottom out. I think that's been maybe 50 to 100 basis points of drag here for the last couple of years.

So is there these new products launch and those issues come off, it seems like there's some tailwinds here going into 2015 and I know you're not providing 2015 guidance but is it right to think of some of those things coming off as providing some incremental tailwinds in the next year?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

Yes, Jeff, obviously we'll -- you hit it in terms of we'll give 2015 some thoughts on 2015 a little bit in more depth here in the next call, but I think there's a number of pluses and minuses here. Jim spoke, I think, to the implant momentum and obviously, any additional momentum there is certainly helpful relative to the non-dental product in the US that's being in-sourced. That will be a headwind here for a little bit yet but sequentially, a little bit less for the next couple of quarters.

Obviously a big factor for us is Russia, CIS in the context of basically how that looks, that continues to be a headwind of about 140 basis points on the European number. So from that angle, any improvement there is certainly going to help us.

You hit it in terms of new products. I mean, innovation drives our business. Jim hit several of those and obviously, as we have stronger innovation cycles, that certainly should help us as well. But again, I think there's a number of pluses and minuses with it, but I think that overall, we certainly are pleased with a little bit more momentum we had in Q3.

Jeff Johnson - *Robert W. Baird & Company, Inc. - Analyst*

Understood. Thanks, guys.

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

Thank you.

Operator

(Operator Instructions)

Jon Block, Stifel.

Jon Block - *Stifel Nicolaus - Analyst*

Hello guys and good morning. Maybe just two or three questions. Chris, the first one, the gross margins were really big and I know you called out good mix, but you had that performance even in light of no longer benefiting from sort of built-in inventory. I know you've seen gross margin expansion worth of 100 bips from -- since early 2012.

Can you just maybe parse out for us, in your opinion, what level of the expansion is sustainable? And then we look out to the 20% out margin goal, maybe going forward from here, how do you see that mix between OpEx leverage and further gross margin expansion?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

Yes, let me answer the second part first and then we'll come back to the quarter. As we look at the 20% operating margin goal, Jon, we see opportunities both on the SG&A side as well as on the gross profit side.

Relative to the gross profit side, specifically capacity utilization and obviously the procurements leverage that we think we can get at by acting in a far more coordinated manner globally. It's certainly helpful to that gross profit line and obviously, we'd anticipate that gaining more momentum as we move forward.

On the SG&A side, obviously as we look to leverage our SG&A base more effectively across our businesses, I think that's certainly help -- most helpful there. So I think I would characterize the improvement to the 20% operating margin goal as really hitting both lines pretty materially.

In terms of the quarter, the gross profit rate, we were up 110 basis points. We had the two largest impacts. They were price and mix, in that order.

I think that certainly we also did have a bit of improvement in terms of underlining manufacturing costs. But, again, I think we certainly focus on both price and mix on an ongoing basis. We are pleased with the result in the quarter.

Again, I don't know that I would say that I would anticipate 110 basis points every quarter in terms of gross profit rates, but I also think that these are strategies in place by our businesses in terms of being aggressive where they can be on price and also focusing on what they can do particularly through innovation to drive to higher-margin products.

Jon Block - *Stifel Nicolaus - Analyst*

Okay, great. Great. Maybe just two more. Bret, for you, the efficiency, that's been impressive and quite honestly, a little bit quicker to materialize than we thought especially in light of still modest growth in the industry.

And I believe you've even got a little bit of n FX headwind on the out margin. So you're upwards tracking towards probably 70 basis points here in 2014. I think you initially said you expected the cadence to be somewhat consistent to the 20%.

Is this something where as you sit here six months post, putting some of the initiatives in place, you feel very confident about getting 20% in 2017 and if market growth comes or returns, you could even see going north of that?

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

I think the easy answer to that question is, yes, we're very confident we can get to the 20% by 2017. It's ingrained in all of our planning. We've got a number of initiatives underway to make sure we achieve that. So I think you should view the confidence as high that we'll get there.

As far as the phasing or the timing of that, thus far this year, it looks a little bit linear. I don't think it will be linear throughout this three-year period because some of it will be event driven. So there will be some periods where we get greater margin expansions.

There may be some periods where we give a little bit of that back as we make reinvestments or for whatever reason. So we're pleased with where it's gone so far.

It does look linear so far but it's unlikely to be linear going forward. I think the entire organization is fully engaged to make sure we make that 20% target in 2017.

Jon Block - *Stifel Nicolaus - Analyst*

Okay. And last one, if I can just quickly get one additional one there. Bret, I think this one is also for you. Just on the implant side, more than implant mix, I'd go more down the road of channel mix. You had Schein with BioHorizons and getting a new implant out here recently approved in the US and then yesterday's announcement between Patterson and Straumann.

It seems like some of your competitors are getting a little bit more aggressive in the US specific to the GP channel. And maybe if you can just give us your thoughts on how you see that evolving and will you change your selling efforts specific to that channel in the coming quarters years? Thanks guys.

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

Sure. Let me comment on the model that has existed in the US for some time which is a referral model. I think Jim mentioned that. Typically, an implant because, one, it's difficult; two, there's a fair amount of risk including legal risks implant. By far, it's the most litigated area of dentistry that we know of.

And the consequences of an implant failure, of course, are much greater and much more obvious than almost anything else that we do. We believe that the current model has developed because there's a fair amount of expertise required in placing the implant, placing the screw, but not as much expertise required in restoring the implants.

So and Jim mentioned, this makes product conversions a little bit harder in this market because you've got to convert both the specialist and the general practitioner that's going to restore the implants. That models work pretty well. We seen failure rates well under control. And that is a model that we continue to reinforce.

You mentioned a couple of competitors. I don't want to talk specifically about what any one other competitor is doing but we've seen the models evolve over time. We've seen different competitors try different strategies and frankly, we watch those closely to see if they're indicative of a market shift of any kind that we need to participate in or react to.

So at this point, I would say we're watching it closely but staying with our support of the surgeon in placing the implant and the referral model for the restoration by the dentist.

Jim Mosch - *DENTSPLY International Incorporated - EVP & COO*

Great. Thanks for your time, guys.

Bret Wise - *DENTSPLY International Incorporated - Chairman & CEO*

Okay, thank you.

Operator

It appears there are no further questions at this time. I'd like to turn the call back over to our speakers for any additional or closing remarks.

Derek Leckow - *DENTSPLY International Incorporated - VP of IR*

Okay, thank you very much for your support and interest in Dentsply. That concludes our conference call. If you have further questions, I'm available today for follow-up. Good-bye.

Operator

Thank you. This concludes today's conference. We appreciate your participation.
