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XRAY - Q3 2013 Dentsply International Inc Earnings Conference Call

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OVERVIEW:

XRAY reported 3Q13 reported net income attributable to Co. of $79.9m or $0.55 per diluted share. Expects 2013 adjusted EPS to be $2.33-2.38.

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PRESENTATION

Operator

Good day, everyone, and welcome to the DENTSPLY International third-quarter 2013 earnings call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Derek Leckow, Vice President of Investor Relations. Sir, you may begin.

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

Thank you, Allen. Good morning, everyone. Thank you for joining us to discuss DENTSPLY's third-quarter 2013 results. I'm here today with Bret Wise, Chairman and CEO; Chris Clark, President and CFO; and Jim Mosch, Executive Vice President and COO.

I hope you had a chance to review our press release issued this morning. A copy of the release, and a set of slides to accompany this call, are available for download on our website www.DENTSPLY.com, under the financial info quarterly results tab.

I would 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 our SEC filings.

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. As you can see in our release, our results this quarter include a few nonrecurring items and other non-GAAP adjustments. Our comments on this call will focus on results, excluding certain adjustments that provide operational insight, excluding these items.

These items are noted on the non-GAAP reconciliation tables contained in the release. You will note that our earnings guidance is also presented on an adjusted basis.

A recording of this call in its entirety will be available on our website. With that, I would now like to turn the call over to Bret Wise.

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

Thank you, Derek. Good morning, everyone. Thanks, again, for joining us on our call this morning. I have a few overview comments on both the market conditions and then our overall results, and then I'll turn the call over to Jim and Chris for a more in-depth discussion of the results.

First, on the market, we continue to see the overall market as relatively stable versus what we saw late last year, and then also early in 2013. The US continues to be a growth market. Europe is flat at best, as we've seen for some time now.

And the rest of world varies, with the developing regions growing nicely, and the developed regions in a low-growth stage. So, overall, marketing conditions are generally consistent with what we've reported on our second-quarter call.

With respect to our results, we reported sales growth of 3.4%, ex precious metals, this quarter. Internal growth and constant currency growth were both 2.7%, and that's the same that we reported for Q2. And currency in the third quarter was slightly positive, up 70 basis points.

Our internal growth was strongest in the US and rest of world. US was up 4.3% and rest of world was up 6%. And growth continued to be slow in Europe, where we grew 0.3% in the quarter.

In the US, several of our new product launches, this year, are doing quite well. And, we have some interesting products that will come to market in the next couple quarters. Jim is going to comment further on this in his remarks.

In Europe, this quarter, marks the 15th straight quarter of positive internal growth for us in the region, which is quite remarkable, given the economic climate there. Like the US, we're getting some help from our new products, but essentially no help from economic conditions. And although there's -- we followed the recent news of slightly improved economic conditions in Europe, I'd remind you that dentistry is typically a trailing indicator. So we do not expect an immediate reaction in our markets, but rather dentistry would likely respond in a couple quarters.

Our rest of world sales, again, were up 4.6% this quarter, which is a nice sequential improvement. Overall, we saw high single-digit growth in the emerging economies, and low single-digit growth, overall, in the developed regions that we have in that category.

From a product category perspective, all four of our principal product category groups grew in the quarter, with the strongest growth rates in medical and the dental specialties. With respect to our adjusted earnings, on a 3.4% top-line growth, we reported 7.2% operating income growth, reflecting a 60-basis-point improvement in operating margins.

On prior calls, we've talked about our emphasis on operating margin expansion this year, both from a gross margin perspective but also from the expense line. We feel like we're making pretty good progress in both these areas, and we're pleased that we're now reporting operating margin expansion on a year-to-date basis as well.

Overall, adjusted EPS improved 11.8% in the quarter -- that's over 3 times the rate of top-line growth, bringing our year-to-date EPS growth to 6.1%. Looking ahead, we're confirming our guidance for the full year at adjusted EPS of $2.33 to $2.38 per share. This, again, is on an adjusted basis. A couple factors that we're watching closely are dealer-channel inventories and new product introductions.

On the former, last year, you may recall, we had two price increases -- October 1; then, again, on January 1 of this year. And, due to these dynamics, our dealers held inventories high going into the end of last year. And, on our call for Q4 last year, we commented that boost our total sales in the fourth quarter by what we viewed as probably 1%.

This year, we're not planning an end-of-year price increase, so we expect that dealers will reduce inventories in the fourth quarter, following the October 1 price increase this year that we just implemented. So, this year we probably will see a liquidating dealer inventory channel versus the build that we saw in the fourth quarter of last year.

The second item of importance, I think, is new products. We have a pretty good slate of innovation coming to the market this year, including in the fourth quarter. That should be a positive development and partially offset the dealer inventory reduction that I just mentioned.

Of course, we'll update you on this when we report our full-year results in February, and at the same time, we'll provide guidance for 2014. So I would like to now turn the call over to Jim. He's got a few comments on the implant integration and also the new product portfolio. Jim?

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

Thank you, Bret. I'd first like to review our implant business.

In Q3, our global implant sales were flat on a constant currency basis. US was up mid-single digits, Europe was negative, and the rest of world showed sequential improvement, up mid-single digits.

As discussed in our second-quarter call, we went live with the consolidated DENTSPLY Friadent and Astra Tech German organizations in Q1 of this year. To date, good process has been made on training, customer transition, as well as consolidation of operating systems, which are now complete.

Based on trends we observed in other major markets following integration, we are now at a point where the organization is returning to a normal level of competency and effectiveness, and we expect to return to growth in this important market in 2014. From a marketing perspective, in October, DENTSPLY Implants Germany held an implant congress in which 400 plus clinicians attended.

We are very pleased with the response and results, and, in particular, the strong interest in our technology base. It is important to note that we have continued our integration efforts with the implant business as we've worked to realize identified synergies. Consistent with our integration plan, we took a small restructuring charge in Q3, and we'll take a second charge in Q4 as part of our ongoing efforts to improve operating performance of the implant business.

Turning to new products, 2013 has been a good year for launching new innovative brands. Thus far this year, we have launched a new composite system, TPH Spectra; two new fluoride varnish brands, NUPRO Varnish and Durashield CV; and a new endodontics system, ProTaper Next; as well as numerous other innovations discussed on previous calls this year.

In addition, we have recently launched several additional new products that we believe will be very impactful to the market, and will be received well by our customers. First, in our restorative segment, we have a significant launch, Aquasil Ultra Cordless. This is a novel, one-step system for taking impressions in crown and bridge applications, which in most cases, eliminates the need for the use of a retraction cord.

[Aqui] retraction cord is a time-consuming process for the clinician, and can be uncomfortable for the patient. Our new system consists of a unique Aquasil-based tissue management impression material, and a pneumatic delivery device. The device expresses the material through a small canula that is inserted between the tooth and the gingiva, making the procedure simpler and more patient friendly, and eliminates the need for a retraction cord.

Aquasil Ultra Cordless reduces the time for a cord placement and impression-taking procedure by up to 70%. Impression taking is a large part of the market, and we expect this new, innovative technique to have a meaningful impact.

In our preventive segment, we have a number of new product launches. I will highlight two. The Cavitron Prophy Jet is an updated air polishing system, with Tap-On technology that is designed to improve ergonomics by reducing foot-pedal usage and adding a prophy mode that auto cycles between air polishing and rinse, thereby improving the prophy procedure.

Second, is the Midwest Automate, a single station for providing automated and consistent maintenance for various hand pieces used in the dental operatory. The automated maintenance station will aid in improving the useful life of dental hand pieces. And, although it is not new for the market, it is a new category for the Midwest portfolio, which is one of the leading hand-piece brands in the market.

Within our implant group, we launched Simplant 16, a new updated version of the Simplant implant-planning software, with several new features including the integration of Atlantis WebOrder; customized abutments for immediate restoration; and iPad viewer for sharing case-planning information with patients. We are one of the leaders in the market in implant planning and customized digital solutions, and this product leverages our market position and brands through an integrated approach.

Finally, within our endodontics group, we have launched ProGlider, a new variable-taper rotary glide-path file that can create a glide path in most cases with only one instrument, compared to two to three instruments for traditional technology, providing simplicity and speed for endo specialists and general practitioners. Overall, 2013 has been a good year for DENTSPLY in regards to new product development and product launches, which is a key growth for overall performance.

I will now turn the call over to Chris for the financial overview.

Chris Clark - *DENTSPLY International Inc - President and CFO*

Thank you, Jim. Good morning, everyone. I'd like to provide some detail on our third-quarter results by reviewing key elements of our income statement. And also provide some additional color on our balance sheet and cash flow for the quarter.

Our sales growth, excluding precious metals, of 3.4%, and our non-GAAP earnings per share growth of 12% for the period, reflects some volume improvements in both our US and rest of world geographic regions, increased leverage in our operating model, and also the impact of synergy benefits. Our growth was largely organic, with 2.7% internal growth, and currency translation impact of a positive 70 basis points compared to the prior-year quarter.

Gross profit, on an adjusted basis in the third quarter, was 56.6% of sales, excluding precious metals, which was down 30 basis points from the prior-year comparison of 56.9%. This was entirely due to the headwinds in the medical device excise tax in the United States, and a gross profit rate on an adjusted basis would have been up slightly compared to prior year, without this impact.

SG&A expenses, on an adjusted basis, were $259 million in the quarter, or 38.7% of sales, excluding precious metals. That's a 100-basis-point improvement from last year's 39.7% SG&A rate.

On a year-to-date basis, (technical difficulties) are down 90 basis points as a percentage of sales, excluding precious metals. And we're pleased with the improved leverage and synergies across our businesses, including the impact of our cost-saving efforts and integration activities.

Operating margin for the quarter improved 60 basis points to 17.9% of sales, excluding precious metals, on an adjusted basis, compared to 17.3% in the third quarter last year, reflecting the SG&A and the gross margin impacts that I just described. On a year-to-date basis, operating margin has improved 20 basis points compared to prior year. We're pleased to be delivering operating margin improvement, despite the continued muted market conditions in a number of countries.

Our reported tax rate for the third quarter was 14%, while our operating tax rate was 22.1%, which is consistent with our expectations for the year. Net income attributable to DENTSPLY International, on an as-reported basis in the third quarter, was $79.9 million, or $0.55 per diluted share, compared to $53.4 million, or $0.37 per diluted share, in the third quarter of 2012.

These results include a number of items, which we've listed in the schedules and the release. On an adjusted basis, net earnings grew 12%, to $82.2 million, or $0.57 per diluted share, compared to $74.1 million, or $0.51 per diluted share, in the third quarter of 2012.

Moving on to cash flow, our operating cash flow in the quarter was $126 million, up 31% from $96 million in last year's third quarter. This brings our year-to-date operating cash flow to $258 million, a 28% increase from prior year to date, despite some investments in working capital.

Our cash flow performance in the quarter, allowed us to reduce debt by an additional $108 million, and our net debt-to-capital ratio now stands at 35.8%, a significant improvement from the 48.2% net debt-to-cap ratio immediately following the Astra Tech acquisition in September, 2011.

Inventory now stands at 118 days, which is up 7 days compared to September, 2012, and up 2 days from the end of June. As we discussed on this call last quarter, we strategically increased inventory in a few businesses as part of transition plans associated with anticipated operating changes.

We expect that inventory may continue to increase slightly, for another quarter or so, to support these efforts, before returning to more normal levels as we move through 2014 and 2015. Accounts receivable days were 64 days at the end of September.

Capital expenditures were $27 million in the quarter, bringing year-to-date level to $74 million. And we continue to believe our capital spending will be in the $100 million range for the year. Depreciation in the quarter was $20 million, while amortization was $11 million.

Looking at capital deployment, our approach continues to be focused on balance, as we look to support internal investments, return cash to shareholders through share repurchases and dividends, strengthen the Company through acquisitions, and also continue gradual debt reduction. Year to date, DENTSPLY has returned almost $100 million of cash to shareholders in the form of dividends and share repurchases. We repurchased 1.7 million shares during the first nine months, at an average cost of $41.89 per share, but still have approximately 14 million shares available for repurchase, based on the Company's authorization to maintain up to 34 million shares of treasury stock.

Finally, as Bret stated, our 2013 earnings-per-share guidance remains at $2.33 to $2.38, on an adjusted basis, reflecting our assessment of continued above-market performance, but also the impacts of continued high dealer inventories, and ongoing soft market conditions in Europe. That completes our prepared remarks. We appreciate your support, and we'd now be glad to answer any questions you might have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jeff Johnson with Robert Baird.

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

Hey, Bret, wanted to just start on the dental implant side of the Business. Wondering -- it sounds like some declines there again this quarter? Maybe you could flesh out -- and that's a comment in Europe, obviously -- wondering if you could flesh out the European market, especially what you are seeing in Germany now that the sales force integration is complete there?

And Jim, would like to hear, maybe, what gives you the confidence that that dental implant growth turns positive again in 2014, as you talked about in your prepared remarks?

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

Jim, why don't you just take all that, because you're better prepared than I am.

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

Absolutely. Thanks, Jeff. I think, obviously, we've continued to see challenges in the European market overall. From the standpoint -- the issues in southern Europe, maybe, while improving slightly, are still negative. And I think we have just seen a general slowness in Europe overall. So, we have not seen a real change in the European implant market.

All indications are that the German implant market is negative. And we think that this, to some degree, is undermining some of our recovery and our growth. But from the standpoint of our German implant business, the situation that we've seen in the major markets where we've gone through integration, there is this six- to nine-month period as you go through -- really, you're now educating two sales forces on each other's implant systems. You have customer transition, getting to know new customers, building relationships, familiarity with operating systems.

There's just a series of general things that you go through in the transition process. And, obviously, we'd like that to be quicker, but we're also realistic about how much time that it takes, and certainly, the magnitude in our larger markets. I can say we experienced a similar trend in the US market when we went live there.

My confidence is that we're really seeing those operating transition issues really come to a close. We held the implant conference in Germany, which was very well attended. We had our Organization present as well. And we just saw a lot of positive come out of that.

So, we really see our Organization focusing more on customers and the Business. We really expect that that improvement will take through the fourth quarter, and next year we certainly have higher expectations.

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

All right, great. And just maybe a follow-up on that, Jim. It sounds like US was up mid-single digits, rest of world up mid-single digits on the implant side. Europe, down, as you said. Would that have been down mid-single digits? And maybe, sequentially, if you could compare last quarter to this quarter, was it better or worse?

And then, my only other question would be -- in Germany especially, on the dental implant side, how much of it do you think, at this point, is macro versus the generics and clones and those kind of products that are coming into the markets? I'm still trying to figure out Europe -- if Europe for the premium guys can get back to growth any time soon, given the generics and the clones? Or if that market, for the premium players like yourself, is just going to stay negative for some time to come?

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

Well, I think the issue with the generics and the clones -- I think we have to recognize that when you look at the overall size revenue of the implant market, particularly the premium implant market, that's really still the dominant portion of that marketplace. There's no question that the value segment is getting a lot of play right now.

This is an area that we continue to watch very closely, and quite frankly, work to assess what impact it is having. But I would say that I think the trends are really going to be predominantly driven by the growth in those markets, and by the premium players.

We saw some positive signs in Q2 overall, although I think what causes you to pause is that Q1 was very negative. So, as we go into this third quarter, I think it will be very interesting to see, as all the implant companies report, to get a better understanding as to -- do we actually have a positive trend up, or is it really continuing? The reality is, through the first half of the year, the market's still negative. So, I think this quarter will be an important indicator to give us an idea of how that market is trending.

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

Yeah, the other thing I would add to that, Jeff, is just, qualitatively, what we see today is that, in an economy that's growing, the premium implant group does pretty well. We see that in the US. We see it in a lot of the rest-of-world markets. In an economy that's still flat on its back, or not growing, maybe only growing slightly, it's a tougher challenge because there's no economic expansion, no discretionary income growth, et cetera.

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

Great. Thanks, guys.

Operator

Brandon Couillard with Jefferies.

Brandon Couillard - *Jefferies & Company - Analyst*

Hey, good morning. Bret, could you just elaborate on what we saw in the US in the period? Was there any pre-buying ahead of the price increase this year? And can you give us a sense of the magnitude of that price hike?

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

Sure. We do have an October 1 price increase every year in the products that go through distribution, and dealers predictably buy ahead of that price increase to protect their margins as they then liquidate that inventory. I'd say the activity we saw this year, ahead of the price increase, was comparable to what we've seen in prior years -- no major change there.

So, the change that we called out this morning was that last year, because we had yet another price increase coming January 1, dealers kept their inventories higher, even grew their inventories in the fourth quarter, where this year, we think they'll follow the more natural progression of liquidating inventories. Price increases in total were comparable to what we've seen in the past, maybe 1.5%, 2%.

Chris Clark - *DENTSPLY International Inc - President and CFO*

Yeah, pretty much in the traditional range, 1.5% to 2% range.

Brandon Couillard - *Jefferies & Company - Analyst*

Great. Then, Chris or Bret, could you just elaborate on where we are from a capital deployment perspective, and what your priorities are moving forward here? And perhaps give us an update on how you view the acquisition pipeline?

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

Sure. As we said since the acquisition, we were very much in a debt reduction mode. We've worked our debt-to-cap down from 50%-ish to maybe 35%-ish here over the last two years. And the leverage ratio has come down comparably, such that both are very close now, or maybe even in our normal ranges.

So, as Chris mentioned on the call, and Chris may have something to add to this, our capital deployment now is going to be, we think, a more balanced approach, spread between still some debt reduction probably, particularly to the extent we have excess cash flow. And you saw that this quarter. We brought debt down by over $100 million.

Balanced with share repurchases. We bought 1.7 million shares this year. And then also acquisitions. We don't have anything to report today on acquisitions, but we view ourselves in a fragmented industry, and we're a traditional consolidator, and we would expect to continue to participate in that.

Brandon Couillard - *Jefferies & Company - Analyst*

Great, thank you.

Operator

Jonathan Beake with Citi.

Jonathan Beake - *Citi - Analyst*

Hi, guys. Thanks for taking my questions, and just two. Firstly, just if you could give us a quick update on the ortho business -- where you are in terms of market share, and where you're hoping to get to?

Secondly, on the implant business, just to follow up to the earlier questions, we've seen some of your European competitors, or at least both the listed ones ramp up their interest in pursuing a dual-brand strategy. I know you guys are already half there, and already have the experience through [DIA], but whether there's any interest in further increasing your exposure to the discount segment?

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

Yeah, Brandon, thanks very much. In regards to the ortho business, that business has continued to improve. Obviously, we were very much in recovery mode last year, as we exited the market, and then came back into the market.

Our supplier has done a good job of recovering, from a volume perspective. And I believe, when we came back into the market, we did see a sizable recovery of customers that occurred immediately. Those customers that we had strong relationships, we were able to maintain relationships and business through the supply outage.

As we've gotten into the marketplace, obviously our competitors have been very aggressive. And we've been fighting to recover that next set of customers. We think we've made good progress.

We look at it as a third, a third, a third. We recovered probably a third immediately. We continue to fight for the second third, and obviously, we've got more that we have to go after.

We've seen good growth in the US. As we look at the rest of the world, there is some element of a baseline issue, in that we are depending on how we rolled out the recovery. We had a lot of stock-up with our customers, and obviously some of our dealers in the prior year. So, now we're running up against that comparison. But regardless, we're happy with the recovery that we've seen in that business, and we think we could make good progress across several initiatives.

Chris Clark - *DENTSPLY International Inc - President and CFO*

I might add to that that I do think the market conditions in ortho remain incredibly competitive. Probably as competitive as we've ever seen, as the competition that took our customers, obviously, when we couldn't supply them, and we're doing everything we can, obviously, to retain those customers, as we're now back in the market. I think we'd categorize this thing as a street fight, and I think that that's very much where we are at this stage.

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

Jonathan, I'll take that value implant question. With respect to value implants and dual branding, I'd say DENTSPLY is probably the king of dual branding in the dental markets. Although usually in these high-end businesses, or the very technique-sensitive businesses, if you are going to dual brand, you need to do it through a separate channel. So, we're watching very closely what's being done in this market.

We have a few concerns about what the profitability of some of these companies are. We've seen a few come up for sale, and they weren't real positive. So, the question is -- can you dual brand a value implant without the customer support that the premium (technical difficulty) companies offer. And I would say our customers are increasingly demanding on new innovation and customer support, including a direct sales force, including the symposiums, opinion leader support, et cetera. So, there are some questions about that business model.

Now, about three years ago at this time, we made an investment in a value implant company in South Korea, so we were participating in the market through that investment. Today, it's not entirely clear how the market is going to shake out, but we're prepared to participate, depending upon what the ending dynamics of the markets are -- value versus premium. And typically those will bifurcate in dental markets. And we've seen that in other dental markets around the world.

Operator

Erin Wilson with Bank of America Merrill Lynch.

Erin Wilson - *Bank of America Merrill Lynch - Analyst*

Hi, thanks for taking my questions. Can you give us an update on the impact of the exclusion of the gray markets distributor in rest of the world? And have you been able to recover some of those sales?

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

Yes, absolutely. As mentioned in our last call, we identified some gray market activity in our central eastern Europe, Middle East, Africa area. We did take some action, and obviously that did have an impact on our rest-of-the-world sales, primarily due to that market.

We've engaged in a very diligent process as it relates to how we evaluate new distributors. We put that process in place; it is rigorous. I think it really helps us to identify the quality capabilities of those dealers, and also, as well as business practices. And so, we've continued to add dealers, and we saw a nice improvement, in that area, in the third quarter.

Those new dealer additions have had an impact. I think they've added quality to our Business. And we feel that that business is recovering to more normal conditions.

Erin Wilson - *Bank of America Merrill Lynch - Analyst*

Okay, great. And can you speak to the underlying demand trends in the US from a volume perspective? You touched on this earlier. But also just given the changes in the dealer inventory, how should we think about the quarterly progression of organic growth trends?

Chris Clark - *DENTSPLY International Inc - President and CFO*

Erin, it's Chris. Relative to volume, I think that as we look forwards in terms of improved internal growth in the US, there is some volume in that, based on our analysis. And I think that's encouraging, certainly from our perspective.

As Bret mentioned, in terms of inventories, inventories, again, we had the price increase October 1, so dealers bought in, in advance of that. Pretty typical in terms of levels, I would say.

I think the factor that we've really got, as we look to Q4, is that we're going in against a base period where not only did they buy in, in advance of Q4 last year, but they kept inventories high. And in some cases, added to that in advance of the January 1 price increase, which, again, based on, really, the unfavorable comparison we're going to be running up against. So, we've got a period come up here in Q4 that we anticipate dealer inventories in the US to liquidate, and going up against a period in the prior year where they were high and actually increased.

Erin Wilson - *Bank of America Merrill Lynch - Analyst*

Okay. And just one quick one, and broadly speaking here, from a capital deployment standpoint, if you are truly in more of an acquisition mode five years down the road, what businesses really make sense for you? What do you expect as far as businesses or geographies do you expect to emphasize or deemphasize going forward?

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

Erin, this is Bret. That's a really tough question, particularly looking that far out, because we're such a fragmented industry, and sometimes acquisitions are opportunistic, meaning you need a willing seller in order to transact.

But I'd say that, generally speaking, we're looking for technologies first, meaning some technology that would supplement our existing portfolio in one of our six verticals, and now seven verticals including the medical group that we have. Second of all, we'd be looking for strong brands in markets where we have a somewhat weak presence. And third, we'd be looking for distribution, or increasing our channel activity. And priority is probably in that order.

But it's hard to predict which of the seven verticals that we would be transacting in, over the next five years. It would be a little bit, somewhat opportunistic, in that regard.

Erin Wilson - *Bank of America Merrill Lynch - Analyst*

Great. Thanks so much.

Operator

Robert Jones with Goldman Sachs.

Robert Jones - *Goldman Sachs - Analyst*

Thanks for the questions. Just looking at SG&A, and trying to get a better sense of how we should be thinking about spending going forward. Bret, you mentioned operating margin expansion being a big focus. And you guys clearly have done a nice job managing spend this year, even as sales have started to come back.

I'm just wondering if maybe you could walk a little bit more through the pushes and pulls on the SG&A line, as we move forward? Specifically, trying to get a sense of how we should be thinking about synergies from Astra Tech against -- you mentioned new product launches. Any expenses that we should be considering as we enter into the new product launch cycle?

Chris Clark - *DENTSPLY International Inc - President and CFO*

Sure. Robert, it's Chris. I'll take a shot at that. As we look at the SG&A rate, obviously we're very pleased with the leverage we've gotten here in the last couple of quarters. And year to date, obviously, we're down, as I mentioned, 90 basis points as a percentage of sales. I think that does reflect, certainly the focused effort on the integration activities, and we would anticipate that continuing. But it also reflects that in our base businesses, we're really focused on driving cost savings as well.

I would say, with respect to new products, we generally focus heavily, as you know, on new products. And as such, I think there's a fair amount of new product expenses, if you will, that's not only in our current P&L but also in our prior-year base. And I think that that's really pretty steady for us, if you look at it, really, across our portfolio of businesses over time. So, I wouldn't really anticipate, necessarily, a significant bubble there.

I would say that, as we look at it, we've got a headwind, as you know, this year, in 2013, on the gross profit line related to the medical device excise tax. And I would anticipate, as we move forward into 2014 and we annualize that impact, that the balance of the operating margin improvement may be a little bit more balanced, if you will, between gross profit and SG&A moving forward. So, I think right now, obviously, with the headwinds on the medical device tax, we've been really focused on the operating expense side. And again, I think that as we move forward we'll probably be a little bit more balanced on that.

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

The only thing I would add to that, Robert, is that you'll see us take these small restructuring charges from time to time; we took one here in the third quarter. That's us going after the fixed cost structure to try to improve the efficiency, both within our verticals and then across verticals as well. Because sometimes there are synergies there as well.

Robert Jones - *Goldman Sachs - Analyst*

That makes sense. I know you guys both just mentioned the new product launches. I know, obviously, it's just part of the business model. But I'm just trying to get a gauge -- as we head into 2014, as far as this launch cycle goes, relative to prior years or relative to a typical year, any sense you can give us as far as -- are there more products coming into the market in this upcoming year? And maybe anything around mix as to how we should be thinking about the impact on the top line from your new schedule of launches? That would be helpful.

Chris Clark - *DENTSPLY International Inc - President and CFO*

Yeah, again, it's Chris, I'll take -- as you look at new products, I mean, we introduce north of 30 new products a year. And, again, we really focus hard on ensuring that, across our verticals, if you will, that we've got a pretty consistent pipeline, if you will, of new products coming over time. So, for that end, again, I would just characterize it as not really a single event or a single bubble, but really more of an ongoing process. So, I really don't know that I'd say I see a necessarily significant change, either up or down, either in terms of necessarily impact or, for that matter, aggregate spend.

Relative to mix, our new products do, obviously, help drive our sales mix. And, in general, when we bring differentiated technology to market, that typically can help the gross margin mix. And so, from that angle, I think that's usually accretive to us or certainly helpful to us over time. There may be some initial launch costs that may bring that down a little bit, but certainly the newness of our portfolio helps us to differentiate in the [drag] price.

Robert Jones - *Goldman Sachs - Analyst*

Great. Thanks so much.

Operator

John Kreger with William Blair.

John Kreger - *William Blair & Company - Analyst*

Hi, thanks very much. Jim, a quick follow-up on the ortho market. On a unit basis, do you think the market is growing at this point, or flat?

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

I would anticipate that it's flat.

John Kreger - *William Blair & Company - Analyst*

You think it's flat now. Okay.

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

I think it likely, just to add to that, I think it varies by region. Certainly, US can be a growing market for volume, but Europe is probably not at this point. So, on balance, it's probably flat or maybe slightly up. But very, as Chris mentioned earlier, and Jim said also, it's a very competitive market at this point.

John Kreger - *William Blair & Company - Analyst*

Great. Thanks.

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

There's no question it's a very economically driven market. So, as we see a lack of a robust economy, it is an elective procedure, so we won't see the growth. So, I think, overall, we have some regions that are showing little signs of hope, but overall, I think it still remains pretty flat.

John Kreger - *William Blair & Company - Analyst*

Okay, thank you. Bret, I'm sure you're still in your planning mode for next year, but any initial thoughts? Do you think you can be up in the double-digit earnings growth mode?

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

As you noted, we're early in the planning stage. I would rather defer that discussion until we come back on our fourth-quarter call. As we normally do, we'll give you guidance at that point. So, I think it's too early to send signals on that at this point.

John Kreger - *William Blair & Company - Analyst*

Okay. Thanks. And then, maybe one last one. Where do you stand on the Astra integration at this point? What should we assume will be coming up in 2014 on that front?

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

Actually, I would say, for all intents and purposes, we are complete. We had our last go live in Japan in June. That was our last major market.

We did France and Germany at the beginning of the year. So, we've really completed that integration for, really, all of our operating units around the word.

However, obviously, we have a multi-year integration plan, and as I mentioned in my comments, we continue to work to realize the identified synergies, and we work toward that plan. And I think, as we are right now, I think that's consistent with what we had expected. So, I think the major efforts will -- our ability to continue to execute that integration plan and realize the synergies.

John Kreger - *William Blair & Company - Analyst*

So, Jim, is the manufacturing consolidation done?

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

That was not identified, and that is not part of the process. What we have done, to be clear on that, is that we have in-sourced some products that were outsourced previously. We've in-sourced the net into our manufacturing operation in Germany. And that was also part of that integration plan.

Chris Clark - *DENTSPLY International Inc - President and CFO*

It's Chris. I'd add that, John, that's a multi-year effort. And, again, I think that's something we began getting some benefits on earlier this year. Benefits in 2014 will be even larger; and 2015 will be even larger than that.

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

I think where Jim was going there in his earlier comments was that the sales and marketing (technical difficulty), which, to us, is the most difficult part, is now complete. And just like in all of our Business, we're focusing on efficiencies across the platforms and cost savings. So, that's ongoing.

John Kreger - *William Blair & Company - Analyst*

Great. Thank you.

Operator

Steve Beuchaw with Morgan Stanley.

Steve Beuchaw - *Morgan Stanley - Analyst*

One clarification on currency -- just a housekeeping question. Did you give us an update on your estimate of the impact of currency changes, year on year, embedded in the earnings outlook for 2013?

Chris Clark - *DENTSPLY International Inc - President and CFO*

Yeah, I can do that, Steve. As we look at it, we think, at this point, based on current rates, we're expecting a negative impact for the year between $0.04 and $0.05. That's about a penny improvement versus what we had coming into the third quarter.

By the way, in the third quarter, it was negative impact of about a penny. It reflects a positive euro comparison, as the euro has moved here. But also negative impacts, if you will, in emerging market countries, and also developed countries outside of Europe, as well as less favorable impact from our cash flow hedges compared to last year.

Steve Beuchaw - *Morgan Stanley - Analyst*

Thanks, very helpful. And then, one on pricing specific to the US. I wonder if you could give us a sense for, as we think back to the pricing strategy that you and the rest of the market took coming into this year, how much of that pricing would you estimate has stuck? How much is that contributing to market growth in the US? And considering that we've probably picked up that there's some price inelasticity in the market, why not be a little bit more assertive on pricing into 2014? Thanks.

Chris Clark - *DENTSPLY International Inc - President and CFO*

Yeah, it's Chris. Again, our typical price increase is in the 1.5% to 2% range. We were a bit north of that this year, between the October 1 price increase last year, as well as the January 1 price increase this year.

If I had to put a range to it, probably, on average, maybe 1 point north of historical norms on average. And we think the bulk of that has stuck. We don't think necessarily all of it has stuck. Again, we highlighted a few of the pretty competitive markets, orthodontics being one that obviously becomes a little bit more challenging.

That said, I think that, for us, we do think price is an important variable, along with innovation, and a lot of other things, that really drive our leverage, and drive our earnings. Again, that's something that we'll look to be on the reasonable end, but certainly make sure we're not out of whack compared to market. But where we've got some pricing opportunities, we've historically been pretty apt to take them.

Steve Beuchaw - *Morgan Stanley - Analyst*

Got it. Thanks again, Chris.

Operator

Steven Valiquette with UBS.

Steven Valiquette - *UBS - Analyst*

Thanks, and good morning. I actually had the same question on the pricing strategy for 2014, so you just covered that. But just for background around that whole topic, my question is -- does it make sense, from your perspective, to telegraph these price increases to distributors overall?

Just trying to figure out the strategy around that, because my general understanding is that manufacturers are trying to cut down on some of your quarterly sales volatility around this activity. And typically you don't want to do anything to exacerbate it. So, just for background understanding, just trying to get a better feel for the strategy around that? Thanks.

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Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

Well, sure, this is Bret. The distributors are our business partners here, in reaching the market. We don't like to surprise them, and frankly, won't surprise them. So, we typically tell them about our price increases about six weeks in advance.

That gives them the time to do a couple of things. One, develop their own inventory strategy; and two, get the new pricing in their catalogs, so they don't get stuck in a position where they're buying at a higher price, but still selling at an old price in their catalog. So, the discussion with them is balanced, in that, here they're coming and here's what they are, and that gives them time to react.

What we did to take the volatility out of the quarterly earnings for us was we moved all price increases that go through the dealer channel to, at least in the United States, to October 1. And thus, we have the same phenomenon every year. Dealers buying ahead of the price increase on October 1, and then liquidating inventory in the fourth quarter.

That holds true, except for 2012, when we had yet another price increase January 1, and thus they didn't have that incentive to liquidate inventories in the fourth quarter. But, generally speaking, we do telegraph the price increases -- well, not generally speaking -- we always telegraph the price increases to the dealers so they have time to adapt their own business model.

Steven Valiquette - *UBS - Analyst*

Okay, got it. Okay, and then one other just real quick question here, just on the gross margins. I missed some of the color on that. But, again, the key factors that are driving gross margin down a little bit year over year -- how much of that is maybe mix versus other factors?

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

Yeah, I mean, as you look at the year on year, there's a number of impacts there, Steven. A lot of them net, with the exception of the medical device excise tax. So, if you look at it, we're down 30 basis points on an adjusted basis in the Q3 compared to prior year.

The medical device excise tax has been running us between 40 and 50 basis points negative for the year. So, that gives you some color there.

As we look at it, FX is a bit of a headwind as well, to us on the gross profit line. Just to the way that some of the currencies break.

We've had some nice synergies that have helped us on the gross profit line. Mix is, maybe, in aggregate, a little bit negative. And, again, those will swing quarter to quarter.

So, as we look at it, I think, the way to summarize it in aggregate would be, everything pretty well netting, maybe slightly positive, with the exception of the medical device tax. And that's basically saying -- hey, we've got factors that are offsetting a currency headwind on our gross profit rate as well.

Steven Valiquette - *UBS - Analyst*

Okay, got it.

Operator

Jon Block with Stifel.

Jon Block - *Stifel Nicolaus - Analyst*

Most have been answered, but maybe just one or two. The first one, Bret, on Europe. Your 3Q growth rate was largely in line with the second quarter, yet a decent size competitor mentioned what they thought was a slightly improving environment, notably in western Europe.

So, what do you think is going on out there? Do you think your level of share gains, in Europe, are being maintained? Do you believe the environment is starting to turn over in Europe, or do you still categorize it as largely choppy?

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

There's a couple of points here, I think. One is, we have a hard time drawing many conclusions about Europe in the third quarter, because many of those countries basically shut down for a good portion of the third quarter. So, we don't place a lot of reliance on trend changes in that short period of time.

Number two, overall, what we saw in Europe is that the specialties are a little bit weak, and the general consumables are stronger. So, the dental market is still there. It's just the high-end procedures, the high-end discretionary part of dentistry is not picking up or not growing as fast as general dentistry is -- everyday dentistry.

So, we had slow growth in the US -- or excuse me, in Europe -- 0.3% this quarter. The last quarter is like 0.8% or 0.9%. So, it's slowed just a little bit Q2 to Q3, but we're talking about a few basis points here, and we don't place a lot of emphasis on that small change.

The other thing I will add is, qualitatively, what we find in Europe, even today, even in a tough environment, when we bring new innovation to market, even at a reasonably high price point, the dental market there, particularly in the consumable category, the dental market there tends to have an appetite for that, and we get some pickup in our sales growth.

So, we're comfortable that Europe is not changing a whole lot right now. It's still in a low or flat mode. And we're hopeful that the general economy can start to now slowly pick up, and dentistry will usually follow, although at a one- to two-quarter lag.

Jon Block - *Stifel Nicolaus - Analyst*

Okay, great. That's very helpful. And then, just quickly on the implant side of the business. I know there was a lot of earlier questions on the European dental implant market, but in the US, your growth rate decelerated. I think it was low-double digit last quarter to mid-single digits this quarter. Again, one of the lower cost implant guys noted an acceleration from high teens to 20%.

So, can you talk to your thoughts, and I know a couple of the big guys are yet to report, but your thoughts on share within the US dental implant business? And then, how is the premium implant market growing versus the value segment? Thanks, guys.

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

From a standpoint of the US dental implant market, I think we're pleased with our position and our growth in this market. Bret made the comment that with a little bit of underlying economic growth, we've seen some nice growth in the implant market. That's very encouraging for the implant market overall.

The US Organization was our first Organization to go live. They are operating really, I think, at the highest level. We believe that we are taking share in that market.

Your comment regarding double digits to mid-single digits is accurate. We do believe that there were some things in the prior year base, and that, in fact, that our Q3 business is probably stronger than what actually the numbers show. So, we are very positive about that.

From a standpoint of the value players, I think we have seen less commentary and less discussion about that segment in the US market versus other markets. And it's still, we believe, is a very strong premium market. I think the implant companies are recovering well, and performing well, and I think we're pretty confident about our position in that market, and how we're growing.

Jon Block - *Stifel Nicolaus - Analyst*

Perfect. Thanks, guys.

Operator

(Operator Instructions)

Glen Santangelo with Credit Suisse.

Jeff Bailin - *Credit Suisse - Analyst*

Good morning, guys. This is Jeff Bailin in for Glen. Maybe just one question to switch gears here towards the end of the call. On the medical segment, at the top, you guys mentioned that you had some particularly strong results there. Could you comment a little bit about what's been driving the strength? Is it new product launches or market share issues? Any color you could offer.

Jim Mosch - *DENTSPLY International Inc - EVP and COO*

Jeff, from a standpoint of the medical market, I think we've done well in this segment. A lot of our effort, and a lot of our success, has been new product related. We launched a female catheter about over a year ago, and we've seen nice growth from that. Actually, we're really rounding year two of that, and we continue to see strong growth with that product.

And we also launched a male catheter earlier this year, and that has done very well as well. We're seeing nice growth and expansion in both these categories. These were categories that we needed some updates, we needed some improvements. We made the investments, and we've seen very nice results in that segment overall. So, we're pleased with this segment.

I think our emphasis has really been on investment and new product development. The US market continues to expand. Obviously, there's a higher usage of disposable intermittent catheters in this market, and we've been benefiting from that as well.

Jeff Bailin - *Credit Suisse - Analyst*

Great, and then maybe one follow-up, on the rest-of-world growth up 4.6%. Can you comment a little bit about the trends that you are seeing in the emerging markets, and maybe your strategies there to improve product penetration?

Chris Clark - *DENTSPLY International Inc - President and CFO*

Yeah, I mean -- it's Chris. Real quick, on the emerging-market growth, I mean, we're up basically high-single digits in terms of emerging markets. We're seeing pretty nice traction, I would say in general, relative to our broad strategies focusing in on dual branding, focusing in on sales representation, focused on new products, et cetera.

And again, I think that Jim commented on the Middle East, Africa -- reasonable recovery there. And again, I think that overall we continue to view these markets as very accretive to our overall growth rate, both now and moving in the future. So, these continue to be focus areas for us.

Bret Wise - *DENTSPLY International Inc - Chairman and CEO*

This is Bret. The one thing I would add to that is currency risk is pretty high in these markets. Recently, we've seen many currencies de-value slightly against the US dollar or the euro, which creates some headwind getting products into these markets at a reasonable price point. But there's still a good appetite in these markets for dental products, and growth there has remained high-single digit overall throughout this year, so that's been favorable.

Jeff Bailin - *Credit Suisse - Analyst*

Great. Thanks a lot.

Operator

There are no further questions at this time, so I would like to turn it back to our speakers for any additional remarks.

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

Thank you for your interest in DENTSPLY. That concludes our conference call, and I'll be around this afternoon for follow-up questions. Thank you.

Operator

That does conclude today's call. We thank everyone, again, for their participation.