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EDITED TRANSCRIPT

XRAY - Q2 2014 DENTSPLY International Inc Earnings Call

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OVERVIEW:

XRAY reported 2Q14 as-reported net income attributable to Co. of $90m or $0.62 per diluted share. 2Q14 adjusted net earnings was $99.7m and adjusted diluted EPS was $0.69. For 2014, expects adjusted diluted EPS to be $2.47-2.55.

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Nathan Rich *Goldman Sachs - Analyst*

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PRESENTATION

Operator

Good day and welcome to the Dentsply International second-quarter 2014 earnings call.

Today's conference is being recorded.

At this time, I'd like to turn the conference over to Mr. Derek Leckow, Vice President of Investor Relations. Please go ahead.

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

Thank you, Audra. Good morning everyone, and thank you for joining us to discuss Dentsply International's second-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 all have had a chance to review our press release issued earlier this morning. A copy of that release and a set of supplemental slides and information related to the 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 the US GAAP reconciliation contained in today's release also pertain to this conference call. We may make forward-looking statements involving risks and uncertainties, and 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 may 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. The recording this call in its entirety will be available on our website.

With that, now I'd like to turn the call over to Bret Wise. Bret?

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

Thank you, Derek, and good morning, everyone. Thank you for joining us on our call this morning.

I'd like to provide some insights on the market, how we see that by region, and then our performance at a high level. And then I'll turn the call over to Chris -- or Chris and Jim for both operational comments and financial results.

Our market developments, we entered the year anticipating that the markets in both the US and Europe should see some improvement, driven by job growth in the US and then a balanced improvement in economic conditions in Europe. Through Q2, we have not really seen any meaningful improvement in either market.

Rather, it seems that both markets are stable, but in a slow growth mode, so although we remain optimistic these anticipated improvements will materialize, we are bit more cautious about the market conditions than we were earlier in the year.

Specifically, on the market by region, first the US, or North America more broadly, I would describe the market as stable overall, but lacking any real growth momentum. The first quarter this year was slow due to office closures from severe weather on the East Coast. We do believe the market activity improved a bit in April, which may have reflected some pent-up demand, but then the market growth rates seemed to slow sequentially over the balance of the quarter, June in particular.

In Europe, things remain slow with some limited signs of growth. The US market -- the UK market, for instance, continues to be a bright spot. Southern Europe appears more stable than it has been in recent years, and the rest of Europe is a mixed bag.

The Russian, the Ukrainian markets continue to contract, although a slower rate than we saw in the first quarter, but probably still in the -- contracting in the high single digits or maybe even low single-digit range. In the rest of the world regions, the results are also mixed, with most regions growing in the most recent quarter with the exception of Japan and Brazil that both declined on event-driven factors.

In Japan, the market contracted due to the VAT increase that was -- became effective April 1, which clearly moved buying activity into Q1 and out of Q2. In Brazil, the market decline notably in June as the government instituted five additional holiday days in the month of June in connection with the World Cup.

Moving to Dentsply's performance, sales growth XPM in the quarter was up 2.1%. However, internal growth was slightly negative by 0.6% on one less selling day than the prior year quarter, which was a disappointment to us. Constant currency growth was slightly better at plus 0.3% and currency added 1.8% in the current quarter.

US internal growth was slightly positive at plus 0.2% against the challenging 6.2% comp last year, with the growth this year driven primarily by our chairside consumables that were up nicely. However, offsetting this lag continues to be negative.

And in the non-dental segment, we had an industrial customer in-source a product, which reduced US growth by 80 basis points this quarter, and this impact will continue for the next couple quarters. This particular product is a legacy product from an acquisition over a decade ago where volumes are now near zero and it's non-core to our business.

If you look at the dental business, it was up roughly 1% internal in the US. So in US, we had some reasonable performances in certain product lines, but also some categories where we have some work to do.

In Europe, internal growth was generally consistent with what we've been seeing. It was down slightly 1.3%. CIS, again, is a drag on our results and throughout the region, the rest of the region, I'd say growth is hard to find; spotty at best. Ex-CIS and internal growth was down slightly in the region in the quarter.

In Rest of World, we are negative 0.6%, and that was heavily influenced by Japan. Overall, we had positive internal growth in the Pacific Rim; in Latin America, excluding Brazil; and Canada; and in the Mid East; and we were down double digits in Japan. Again, the increase in the VAT tax in Japan, April 1, boosted our first quarter sales ahead of that tax and I think we noted that on our first quarter call. It is now depressing the second quarter result by a comparable moment.

In total, Brazil and Japan took more than 350, probably closer to -- more than 300 basis points out of the rest of world, maybe as much as 350 basis points out of the Rest of World category for us. Recall that we had positive internal growth of almost 9% in the first quarter in the Rest of World regions. So in this category, to take the noise out for Japan, I think the year-to-date numbers probably make more sense to look at, which is 4% internal growth year to date. Also important to remember, Rest of World category represents both developed and emerging markets for us.

Moving to earnings, as we've noted on the last couple calls, we're very focused on improving the long-term efficiency of the business, both at the product cost level and also the overhead structure. This quarter, we are faced with a very tough comparison from last year, when operating margins were 19.2%.

So we're very pleased to have exceeded that level in the current year, up slightly at 19.3%. Adjusted EPS was an all-time quarterly record for us and was up 4.5%, again against a tough comp last year, and in this sales environment, this earnings performance, we think, is a pretty good achievement.

Year to date, sales are up 2.3% ex-precious metals. Operating margins are up 80 basis points and adjusted EPS is up 8.5%. So despite the lack of meaningful pickup in growth, thus far, we remain comfortable with our full-year adjusted EPS guidance of $2.47 to $2.55 per diluted share.

Lastly, before I turn the call over to Jim, as we've noted on prior calls, we are very focused on cash flow generation and improving the return on our investments. We have some pretty good results in those categories this quarter and year to date, and Chris is going to comment more on those in his remarks.

So let Me turn the call over to Jim now for operational comments.

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

Thank you, Bret.

I would like to provide an update on the status of previously launched products, products currently in launch as well as a perspective on a few operational items. I'll then turn it over to Chris for the financial review.

First, in our consumables business, we are pleased with the performance of Aquasil Ultra Cordless launch in Q4 of last year. This is a unique one-step system for impression taking, which in most cases, eliminates the need for the clinician to use a retraction cord, which is a time-consuming step for the dentist and often unpleasant process for the patient.

We had a very successful launch in Q4, which has continued into 2014. To date, we have over 2,300 office using Aquasil Ultra Cordless and anticipate increasing adoption in coming quarters.

In Q1 of this year, Dentsply Implants announced the launch of a new implant system, Astra Tech EV, or Evolution. The EV system has a new drilling protocol, which reduces clinical procedure time, a flexible clinically-oriented surgical tray, and also provides improved initial stability upon implant placement. Early adoption has been excellent and to date, EVR already represents 20% of the previous Astra Tech Implant System volume.

However, one challenge is that we have seen some inventory liquidation by current customers in anticipation of the new system. We will be expanding the launch globally in the second half of 2014 and expect continued success with the EV System.

In our preventive business, in Q2, we launched an extension of the market-leading Cavitron brand with a FITGRIP Cavitron insert. FITGRIP is an advancement on Dentsply's Cavitron Ultrasonic Inserts that adds a fit comfortable grip to lessen muscle load and pinch force for improved ergonomics. FITGRIP has been offered on the nine most popular Cavitron inserts and has had great acceptance to date.

Within our endodontic business, we launched ProTaper Gold in North America the end of the first quarter. Gold is an extension to our market-leading ProTaper endodontic file brand and utilizes a patented heat treatment process, which creates a gold hue.

The process provides greater flexibility to negotiate canal anatomy and also significantly increases resistance to cyclical fatigue or file separation. We are early in the launch, but customer acceptance has gone well and we now begin to roll the product out on a global basis.

Finally, one the more innovative new products in the endodontic portfolio is TRUSHAPE, a new endodontic 3D conforming instrument, which provides traditional root canal preparation while promoting dentin preservation. TRUSHAPE has a unique shape and a highly flexible design, which removes less dentin and maintains the integrity of the tooth structure. TRUSHAPE is the first product in our TRU Platform, which will be a series of products focused on dentin preservation.

From an operational perspective, we announced the consolidation of our Sultan Healthcare business based in Englewood, New Jersey, to Dentsply Professional Division in York, Pennsylvania. This follows an earlier announcement of the consolidation of our Rinn division in Elgin, Illinois, to the Professional Division in Q1.

The purpose of these moves is to create a signal -- a single preventive and infection control business, leverage operational R&D, and SG&A resources, and market the consolidated portfolio globally through our InterCompany locations. In the US, our Sultan sales force will remain independent, but the Rinn X-Ray position accessory products will be managed by our hygiene sales force, providing additional sales resources to support these brands.

Also in Q2, we completed the consolidation of our Materialise Dental operations, which provide implant treatment planting software and surgical guides based in Leuven, Belgium, which has been consolidated into ES Healthcare based in Hasselt, Belgium, which produces implant retained bars and bridges. This follows the integration of various Materialise Dental country organizations into the respective Dentsply Implant locations. These moves are part of a broader strategy to create a fully integrated digital implant portfolio, and are consistent with our efforts to increase asset utilization and improved return on those assets.

I'd now like to turn it over to Chris Clark.

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

Thank you, Jim. Good morning, everyone. I'd like to provide some detail on our financial performance for the second quarter, including our efforts to improve operating margin, cash flow, and asset utilization.

For the second quarter, sales excluding precious metals, grew 2.1% compared to prior year, with constant currency growth of 30 basis points and favorable currency translation of 180 basis points. Gross profit rate on an adjusted basis in the quarter was 58.5% of sales, excluding precious metals, which represents an improvement of 10 basis points over last year's second quarter. I would note the currency moved against us in the gross profit line in the quarter by approximately 30 basis points, so our underlying gross profit rate performance on a constant currency basis was stronger than reported.

SG&A expenses on an adjusted basis were 39.2% of sales excluding precious metals, consistent with our SG&A rate in the second quarter of 2013. Operating margin for the quarter improved by 10 basis points to 19.3% of sales, excluding precious metals, on an adjusted basis. That compares to 19.2% in the second quarter last year.

As we mentioned on the first quarter call, we knew that last year's strong operating margin rate would be a difficult baseline for us quarter so we're quite pleased with our operating margin performance. I would add that currency was a headwind to the operating margin rate of by approximately 20 basis points in the quarter as well.

In addition, we invested approximately another 20 basis points of operating margin back into the business and cost to accelerate our operating margin improvement efforts moving forward. Over the past four quarters, adjusted operating margin has improved by 60 basis points compared to the prior 12-month period, though we continue to be quite pleased with our progress in this area, and believe that we are on track towards our objective of reaching a 20% adjusted operating margin rate in 2017.

Our reported and operating tax rates for the second quarter were both 22.4%. As anticipated, tax represented a bit of a headwind in the quarter, as the operating tax rate was 40 basis points above our 22.0% rate in the second quarter last year. Year to date, our operating tax rate of 22.5% is a 60 basis point headwind to last year's rate and that's consistent with the guidance we provided for the year.

Net income attributable to Dentsply International, on an as reported basis in the second quarter, was $90 million, or $0.62 per diluted share and that compares to $87.2 million, or $0.60 per diluted share in the second quarter of 2013. These results include a number of items, which we've listed in the schedules in the release. On an adjusted basis, net earnings grew to $99.7 million from $95.8 million in the prior- year quarter and adjusted diluted earnings per share grew 4.6% to $0.69 per diluted share in that compares to $0.66 per diluted share in the second quarter last year.

Despite the currency headwind to the operating margin rate in the quarter, the overall impact on -- of currency on earnings for the quarter was neutral to slightly positive, less than a $0.01 per share, due largely to the favorable impact of currency translation on both sales and earnings. Year to date, currency remains a slight headwind to earnings and while rates are pretty volatile presently, at current rates, we would anticipate the currency impact on earnings over the next two quarters to be minimal.

Moving on to cash flow, our operating cash flow for the quarter was $155.7 million, which represents a 60% increase over last year's $97 million. This represents a record quarterly cash flow for the second quarter for the Company.

For the first half of 2014, our operating cash flow of 22.2 -- I'm sorry, $220.2 million represents an increase of $88.4 million over prior year, which is a 67% increase. We continue to focus on driving better cash management and are benefiting in particular from some of the tax strategies implemented, as well as lower investments in working capital compared to prior year.

With respect to working capital, inventories now stand at 123 days, which is up three days compared to March and up seven days compared to prior year. As we mentioned on several previous earnings call, we have strategically increased inventory in a few businesses as part of transition plans associated with anticipated operational changes.

We expect inventory to now begin to decrease in the back half of 2014 and through 2015 as we gradually return to more normal levels. Accounts receivable days were 59 days at the end of June. That's down two days from March and flat to prior year June.

Capital expenditures were $24 million in the quarter while depreciation was $21 million and amortization was $13 million. Net debt improved by over $112 million in the quarter and our net debt to capitalization ratio now stands at 33.5% compared to 39.3% a year ago and 51.3% right after the Astra Tech acquisition. In the quarter, the Company also repurchased just under 300,000 shares of common stock, bringing our year-to-date total to just under 1.2 million shares.

In terms of our capital deployment approach, I want to reiterate that our intent is to continue to support repaying debt while also balancing uses of free cash flow to support reinvesting in the business, acquisitions, share repurchases, and dividends. So really, a balanced approach.

Finally, as Bret stated, based on our first-half results, as well as our current view of the relevant market factors, we are maintaining our adjusted earnings per share guidance in the range of $2.47 to $2.55. This reflects a number of pluses and minuses that we've outlined this morning, including a somewhat tempered view of market conditions, as Bret noted, as well as a more challenging prior-year earnings growth comparison in the second half than what we ran against in the first half. We are also factoring in the momentum we believe we are creating relative to our efforts to improve operating efficiency and to drive better leverage of our cost and asset basis.

That concludes our prepared remarks. We appreciate your support and would now be glad to answer any questions you might have.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Jeff Johnson, Baird.

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

Bret, I just wanted to start with you on some of your market comments. I think the way you're seeing the market is very similar to what we've been seeing the market here in our checks and survey work over the last month or two of maybe a little bit of incremental softness in June and what have you. But as the GDP number comes out at 4% for the second quarter, employment seems to be picking up, maybe even seeing some wage inflation here picking up a little bit, which would be helpful probably from a spending standpoint, what do you think is causing kind of this sluggishness at the dental-market level versus what seems to be, at least in the domestic trends, a little bit strengthening on the macro side?

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

Thanks, Jeff, and that's an important question. We did see the GDP report yesterday, which was quite encouraging for the second quarter, and obviously, dental is a trailing indicator. So if we see strong GDP growth, generally speaking, as history would tell us, that dental will pick up on a couple-quarter lag behind that.

Year to date, GDP is not so great. It's only up 0.9%, I think, through the middle of the year. Obviously, it was depressed in the first quarter for all of the reasons we know about -- weather, et cetera -- but seemed to pick up in the second quarter. And if so, then again, I would expect to see dental improve. It just hasn't improved yet.

On the employment numbers, at the surface, those are also very encouraging. I mean, we saw 288,000 jobs added in June. When you peel that back one layer, the truth is: We added about 800,000 part-time jobs and lost 500,000 full-time jobs. And of course, the full-time jobs generally have benefits and the part-time don't.

So I think we have to watch those numbers a little more carefully, and understand what the nature of the jobs are. Generally speaking, if you track white-collar job growth, it tracks pretty close to dental growth, and so that's the factor we're trying to watch.

So I didn't mean to be entirely negative on the growth outlook, because we still believe -- or I still believe that the dental markets are going to start to pick up, particularly if we see some economic growth like we saw in the second quarter. If that continues to play out, I think we'll see an improvement over the next couple of quarters.

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

Yes, understood -- helpful. And then, as I look at the organic growth number this quarter, I compare to maybe one of your larger competitors on the manufacturers' side, they don't give exact details, but it sounds like their consumables business was up low-single digits in the quarter.

We haven't heard yet from the distributors. My sense is their consumables numbers might be just a touch stronger than your organic growth was, not by much, but maybe some. So talk to me maybe a little about your share and kind of how you feel like DENTSPLY is competing here against some of the others out there.

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

Okay, well, the data points we have so far is one competitor came out with 2% dental, but said equipment was the growth factor, and consumables were less than that. I don't think they gave the exact number, but I implied that it was flat. Their consumable number must have been flat based on what they said.

We have the industry data through May, which would tell us: On chairside consumables, we're actually gaining share. We do have a drag from lab. We've got -- that's a business that's under repair. We have work to do there. If asked directly -- are we losing share in lab -- I'd say yes.

The rest of the businesses are mixed. We have some very good performance in the -- in everyday dentistry products, some very good product launches; Jim mentioned a few of those. I think we have some upside there.

In the specialty business, implants in particular, I think could be an upside with this new product launch. We'll have to watch that closely.

So overall, I think it is a mixed bag. I don't think we're beating the market by a lot, but I don't think the market is really robust right now either. And the data points you mentioned, we need. We need to see what the dealers report for Q2, and then we'll know more firmly what the market is.

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

Understood. Last question then just, Jim, any chance you could quantify some of the liquidation you mentioned on the inventory side with the EV launch. Where is that happening, US versus Europe? If you could quantify it at all, maybe what that implicate -- might imply for the second half of the year, if some channel inventory has to get refilled, things like that. Thanks.

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

Yes, Jeff, so I think the -- what we've seen is that -- the two markets we went into, we went into the United States, Canada, and then select European markets. And one of the phenomena you see when you launch a new implant system is, obviously, the customer has to go through a transition process. They need to buy a new surgical kit. They're being judicious about their implant purchases based on what they think they might place going forward.

Where they are fairly aggressive is in their abutment stocks. And they recognize that they're not going to be producing these -- or they're not going to be placing these going forward, so they significantly reduce their abutment inventories. And we have definitely seen that.

I think one of the other -- I think maybe it's a positive phenomena, which is that: Transition to a new implant system is not insignificant for a surgeon. And we would expect that if we contact 10 oral surgeons, 4 to 5 would want to make a conversion immediately. And, in fact, I think the success of this system is it's more like 8 out of 10. So that's kind of put some additional pressure on both a capacity standpoint, as well as the inventory impact. We have addressed that issue, and we are prepared for full launch in the back half of the year, particularly in the United States and Germany, and we expect growth from that.

Operator

Robert Jones, Goldman Sachs.

Nathan Rich - *Goldman Sachs - Analyst*

This is actually Nathan Rich on for Bob today. Thanks for taking my question.

First, I just wanted to dive into a little bit more detail on what you saw in Europe in the quarter. I think internal growth was pretty consistent with the first quarter, but was wondering if you could comment on western Europe specifically, and how that performed relative to the first quarter? And just any update on your expectations for what you expect in Europe in the back half of the year?

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

Okay, this is Bret. Like I mentioned, we were down 1.3%, I think, in Europe in the quarter, which is kind of, as you note, it's consistent with what we have been seeing. CIS continues to be a drag there, but it was a little bit less than a drag than it was in the first quarter.

For western Europe, we were still down slightly, less than 1%, obviously, in the quarter, and it's a mixed bag. We got some countries in the south that are growing, some that are stable, some that are slightly contracting. Even the north is a mixed bag at this point. UK is a growth market, and as I mentioned, looks good, whereas France was pretty weak, et cetera. Germany was kind of flattish.

So I don't really have a lot more color than that, other than to say, overall, the trends don't seem to be changing much. They seem to be consistent with what we've seen before. There are moves in individual countries, but overall, the region is performing about as it has been.

Nathan Rich - *Goldman Sachs - Analyst*

Thanks. That's helpful. And then also just very impressive SG&A control in the quarter. And it sounds like you're planning to kind of accelerate your efforts in terms of achieving your long-term operating margin goal.

I was just wondering if you could go into a little bit more detail on how you are able to control expenses in the quarter? Maybe any specific initiatives that you're exceeding plan on? And then how should we think about how the cost savings ramp, not only in the back half of this year, but also into 2015?

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

Okay, I'm going to take a stab at that, and then Chris may have some additional comments. One of the things we've commented on is that we've been building inventory ahead of some operational initiatives. Jim commented on several of those in his prepared remarks today. Those are evidence of the types of moves that we have been making and will be making.

I don't know that I would describe it as that we're accelerating the efforts. The plan we have is a very balanced plan, well-thought-out plan, and the idea is to reduce the fixed cost structure burden on the businesses so they have more variable spend to invest in growth, and that's what we've been doing.

So, like I said, it's not that we're going faster than we were thinking we were going to go. We're going at about the rate we thought we would go, and this is a multi-year, long-term initiative to improve the profitability of the Business and the return on assets.

Now, Chris, I said a lot. Is there anything you'd add to that?

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

I think that's accurate. I mean, again, Nathan, you'll continue to see us provide some insights in terms of the specific actions and strategies as we take them. And obviously, we'll continue to provide you those insights on the call.

I would say that this quarter is pretty consistent with what we've been doing. We're very focused on driving SG&A leverage. We're very focused on driving better asset utilization across our plans -- having our teams work far more closely together. And that drives the benefits that we are seeing.

So, again, we're pleased with the performance, but it's -- we'll continue to execute those strategies. And as we have larger events, or notable events or strategies that are central to that, we'll provide comments on those as we implement those.

Nathan Rich - *Goldman Sachs - Analyst*

Great. Best of luck.

Operator

Steve Beuchaw, Morgan Stanley.

Steve Beuchaw - *Morgan Stanley - Analyst*

A couple businesses that we didn't spend much time on in the prepared remarks -- I'm wondering if you could help us out a bit on. Number one is implants. Could you give us a sense of how the growth there tracked? Any perspective on the market, and regional trends would be really helpful.

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

Yes, Steve. As far as our implant business, growth in Q2 was up low-single digits. On a constant-currency basis, we were slightly negative. We continue to see growth in North America. Europe did contract. And rest of world was up, in spite of a pretty big pullback in Japan that we saw in Q2.

I did mention in my prepared remarks, we have seen some impact as it relates to the inventory liquidation. That was particularly true in North America.

We've only had two companies report thus far; they're between minus 1% and plus 2%. We feel we're in that range. And quite frankly, our focus now is really on the launch of EV, which we think will support us well in the second half of the year. Our digital business continues to perform very well.

Steve Beuchaw - *Morgan Stanley - Analyst*

And sorry if I missed it, but did you attempt to quantify the liquidation impact on the quarter? It sounds like, relative to the market, order of magnitude maybe 1 point?

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

That's kind of difficult to do. I mean, it's across a lot of customers, so you're -- we don't have, obviously, access to inventory at the customer level, so it's really difficult to measure that magnitude.

Steve Beuchaw - *Morgan Stanley - Analyst*

Got it. And then, I wonder if you could spend a minute on the healthcare business, the non-dental piece of the Business? As I reflect back on your comments, Bret, about the performance of dental in North America, I was hoping that you could give us a little color there to help us put together the rest of the puzzle for the full US line? Thanks.

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

Just for clarity, Steve, you want more color on the non-dental piece or on the dental piece?

Steve Beuchaw - *Morgan Stanley - Analyst*

The non-dental, sorry.

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

Okay, non-dental is -- for us, is made up of our Wellspect HealthCare business, which performed quite well in the quarter, but also some, let's call them, legacy industrial lines, dating back -- in this case, dating back anywhere from 15 to 30 years -- acquisitions we've done over a very long period of time. There's not a wide variety of products in that category any more. Those kind of have slowly been phased out of the portfolio.

But in this case, we had one particular product that was produced, generally speaking, for just one customer as a raw material for them to go into their product line. And it hadn't been a product line that had been growing or we've been investing in. But that customer decided to in-source that product line, and so it's basically gone now from our portfolio, or will be phased out over the next couple of quarters.

So this is a non-core issue. I don't think we need to spend a lot of time on it, but it's just one of those small items that was sitting in the portfolio that now is going to be gone.

Steve Beuchaw - *Morgan Stanley - Analyst*

And the legacy Astra Healthcare business?

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

The legacy Astra Healthcare business is the Wellspect business that I mentioned that performed very well during the quarter, and continues to be a really bright spot in the portfolio. It's a business we like a lot.

Steve Beuchaw - *Morgan Stanley - Analyst*

Thanks so much.

Operator

Erin Wilson, Bank of America.

Erin Wilson - *BofA Merrill Lynch - Analyst*

On capital deployment, do you anticipate any sort of change in strategy on the M&A front, specifically in light of [Newbell] on the block more recently? And broadly speaking, I guess, five years down the road, what businesses really make sense for you?

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

Thanks, Erin. I'm going to take stab at that. Chris may have some color to add as well.

Our strategy is to find technologies or companies or brands that improve the portfolio of the Company, and make those investments. We are a -- I would call us an aggressive acquirer, where there's value to be had from a strategic standpoint.

Most likely in dental, that's going to be smaller tuck-under acquisitions. We've made a lifetime career out of doing small tuck-under acquisitions. We think we're pretty good at it. Timing is always a problem or always an issue because these are privately held companies, et cetera. With respect to larger targets, I don't want to comment on any one target in particular, but as you know, we've considered larger targets before, and actually have transacted larger targets for the right strategic reasons.

From a capital deployment strategy standpoint, our first priority is to reinvest in the Business and innovation, and sales and marketing, clinical education, all those sorts of things, which can grow the Business organically. Our second priority is a balance between continued debt reduction, which you've seen us do recently pretty well, I think. Share buyback -- or acquisitions where we can do it would be the next priority, followed by share buybacks and dividends.

I don't think those priorities have changed. We're still -- we would still probably put acquisitions at a higher priority than share buybacks, although we're committed to holding the share count neutral or decreasing it each year as we move forward, so -- particularly given where our debt structure is today.

Chris, do you have -- ?

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

No, I think you hit it.

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

Okay. So that's where we stand on capital deployment strategy.

Erin Wilson - *BofA Merrill Lynch - Analyst*

Okay, great. Thanks. How much would you say new product launches are contributing year to date, and should we expect more meaningful contribution from new product launches in 2015?

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

New product launches are, as they always do, contribute. There's always an amount of cannibalization because we're generally launching, for the most part, in categories where we already have some product lines. We're just trying to improve the practice of dentistry in that product line.

I don't have a great -- I don't really have a good, quantified estimate for you for the impact on new product launches. We did have several key products that launched in the last six months; Jim noted those. We have a pipeline going forward that looks like it could be a little heavier in the back half than it was in the first half. But product launches and new products is a fundamental part of our strategy that's important to the internal growth or the continued growth of the Company. Sorry I don't have a better quantization for you at this time, but I just don't have that at hand.

Erin Wilson - *BofA Merrill Lynch - Analyst*

That's fine, thanks so much.

Operator

(Operator Instructions)

Matt Bacso, William Blair.

Matt Bacso - *William Blair & Company - Analyst*

I guess my question is: To get your 20% operating margin by 2017, how much is that predicated on the market actually growing? Or can you basically get there from current growth rates on the top line?

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

Well, that's a tough question. It would be a lot easier if the market was growing, that's for sure.

The plans that we've laid out would allow us to get to that number, not totally irrespective of market growth, but including a period when market growth was lower than historical norms. So I don't want to say we can get there with zero market growth because I think that would be tough. But the plan is laid out so that such that we can get there without the market returning to the 4% to 6% growth that we had enjoyed pre-recession. And the fundamentals of the plan are that it would allow the Business to really enjoy some prosperity if, in fact -- with these actions -- if in fact, the market did return to that level.

Matt Bacso - *William Blair & Company - Analyst*

Okay, and also, I know you guys mentioned earlier in the year that you were closing a few plants to increase utilization and capacity and stuff like that. How far along are you in that process, and when do you expect that to end?

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

That's a long-term program. The comments that Jim made today were the ones that we've taken thus far. I think there's three actions that have been taken thus far.

There will be more of that because we need to do some consolidation. We need to increase capacity utilization and become more effective on the cost side. But that's going to be a multi-year program where we improve the efficiency of the Business. It won't -- it's not a quick rifle shot.

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

Yes, Matt, it's Chris. I think, again, the same comment earlier holds. As we take those actions, we'll provide perspective on those, obviously, as we move forward and our perspective at that point as well in terms of what that should mean for us, okay?

Matt Bacso - *William Blair & Company - Analyst*

Great, thanks, guys.

Operator

Jon Block, Stifel.

Jon Block - *Stifel Nicolaus - Analyst*

Maybe first one -- thank you. Maybe first one, Bret: We've been speaking about the threat of value or generic implants for a while. And it's always tough to get numbers, but one of your competitors at a recent Analyst Day gave out as high as maybe a mid-teen growth rate for their value offerings.

We've seen some of your premium competitors re-position themselves to at least have a hand in value from an equity state. Can you just talk big picture how you see the implant markets shaking out at the high and at the low end over the next 2 to 3 years? And do you guys need to do anything just to reposition yourselves to capture growth? Thanks.

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

Okay, Jonathan, a couple of comments. There certainly is a lower priced, or I think you used the word generic, implant market. It's not our focus. We're more focused on advancing the science. This is a very risky part of dentistry. I just actually had a dental implant done two months ago, and I now know personally that it's quite an event.

So, our focus is on advancing the science and advancing the practice of dentistry. We're just launching a new premium implant. It comes at a price premium. The market acceptance has been tremendous, and so we can see that the clinicians and patients are willing to pay for value.

On the other hand, we don't dismiss the fact that there is this lower-priced generic segment. We think it is much -- could be as much as a $1.5 billion market now. It's not one to be dismissed. We're tracking very closely what's happening in that market.

We think that profitability is generally low for most companies that are participating in that segment -- not all companies, but most companies. We've tracked, over the last, I think, three or four years, 28 companies in that market, 19 of which have now gone out of business. And then there's been others that have come into the market.

So we are very in tune to what's happening in that part of the market. We did make a small investment four or five years ago in a low-cost implant player in South Korea. We're considering our options there, but we have nothing really else to communicate to the market at this time.

Jon Block - *Stifel Nicolaus - Analyst*

Okay, very helpful. And maybe just a follow-up. In terms of who may or may not be for sale out there, can you speak to -- maybe Bret -- how it could impact you guys if it were to go to this rumored sale to a player that's currently one of the top one, three, four -- excuse me, number-one players out there or private equity. I guess where I'm going with this is: When you guys did AstraTech, do you see a chance -- a greater chance to pick up share if one of the leaders were to make a move for the company that's for sale versus it just going to private equity?

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

That's hard to answer, obviously, because we're speculating on who would be involved in any single transaction. I think that acquisitions cause disruption, and disruption sometimes creates opportunity for competitors, and we just went through that. So we're watching it very closely.

We do know that out of the top five, two of those are merging now or have plans to merge, which will cause some disruption. And the latest rumors about another top player in the market could further cause disruption. But it's hard for me to speculate about the nature of the disruption, and how we would react without knowing exactly what transactions were going to transpire.

Jon Block - *Stifel Nicolaus - Analyst*

Okay, and last one for me real quick. Chris, I think when we started off the year, you mentioned FX headwinds of about $0.04. Is that where we are, or are we closer to $0.02 or $0.03? Can you just, I guess, clean that up as we sit here today?

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

I mean, obviously, it bounced around a fair amount. So we're going to -- it's tough to pin it down to a specific number.

The building blocks I'd give you was we were about $0.02 negative in the first quarter. We were neutral to slightly positive. You should think less than $0.01 a share in the second quarter. And if rates stay where they are right now, they've been -- it's going to be pretty well neutral for the last two quarters -- pretty much a non-event.

Now, that said, there's a lot of pluses and minuses within that. We'll get some help from the Euro. The second tier basket of currencies are still really -- they're down 7.5% compared to a year ago on a year-to-date basis. Again, there's a lot of movement at this stage in the game, but if you just take a look at a snapshot, that would be the best perspective I can give you.

Jon Block - *Stifel Nicolaus - Analyst*

Perfect, thanks, guys.

Operator

Brandon Couillard, Jefferies.

Brandon Couillard - *Jefferies & Company - Analyst*

Bret, could you speak to the endo and ortho businesses? Any changes or developments you've seen in those markets, globally or regionally?

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

Sure, Brandon. First, on ortho, I think we've commented that, at least from our perspective, that's probably the most competitive market in dentistry right now. I mean, there is excess capacity that's been added to that market. There's price pressure. We're still focused on technology and bringing new products to market, and recovering from the product supply outage that we had a couple years ago. So, there's a lot of pressure in that market, and ortho is not a growth market for us at this point.

Endo, on the other hand -- we're a leader in endo in technology. We continue to grow nicely in that category. We're bringing new products to market. Jim commented on some of those this morning. So, endo remains a bright spot for us in our overall portfolio.

Brandon Couillard - *Jefferies & Company - Analyst*

Thanks. Chris, on the cash flow front, any chance you could quantify the magnitude of the inventory opportunity or wind down in the back half of the year? And then, should we think about absolute inventory levels being -- declining on a dollar basis in 2015?

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

Yes, so, again, Brandon, we -- the word I'd give you would be gradual, in terms of the movement. I'm not going to put an inventory target out there for basically year end for us, but I guess I would say I would be disappointed if we don't continue to gradually improve here. There may be quarter up or quarter down, but in short, we should be gradually moving this.

And so you look at our inventory levels right now, 123 days compared to historically where we were, if you go back two, three years ago, the fact is they're up a number of days. And again, our objective is to gradually bring these down. We expect to make some progress by year end. We expect to make more progress through 2015, and then obviously, we think we probably still have some room to go after that.

Again, this is a longer-term focus area. We will be burning down some of the transitional stocks that we've built, but we think that beyond that, there's some movements we can take -- actions we can take to continue to improve, frankly, the overall inventory efficiency and asset efficiency in the inventory line for us.

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

Brandon, this is Bret. I'd just add to that, that there's a lot -- I would say more focus on this issue internally than we've had in some time -- in a number of years. So this is an area that strategically we want to get after.

Brandon Couillard - *Jefferies & Company - Analyst*

Super, thank you.

Operator

That does conclude the question-and-answer session. At this time, I'll turn the conference back over to management for any closing remarks.

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

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

Operator

And again, that does conclude today's conference. Thank you for your participation.