

PATTERSON COMPANIES, INC.

Form 10-Q

March 06, 2019

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

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FORM 10-Q

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF  
<sup>x</sup> 1934

FOR THE QUARTERLY PERIOD ENDED JANUARY 26, 2019.

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

Commission File No. 0-20572

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

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

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

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of February 28, 2019, there were 95,169,000 shares of Common Stock of the registrant issued and outstanding.



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PART I—FINANCIAL INFORMATION  
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PATTERSON COMPANIES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except per share amounts)  
(Unaudited)

	January 26, 2019	April 28, 2018
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 117,431	\$ 62,984
Receivables, net of allowance for doubtful accounts	547,180	826,877
Inventory	845,846	779,834
Prepaid expenses and other current assets	169,209	103,029
Total current assets	1,679,666	1,772,724
Property and equipment, net	290,271	290,590
Long-term receivables, net	96,946	135,175
Goodwill	814,874	815,977
Identifiable intangibles, net	359,601	389,424
Other	79,167	67,774
Total assets	\$ 3,320,525	\$ 3,471,664
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 688,125	\$ 610,368
Accrued payroll expense	72,125	69,099
Other accrued liabilities	121,317	136,316
Current maturities of long-term debt	22,131	76,598
Borrowings on revolving credit	29,000	16,000
Total current liabilities	932,698	908,381
Long-term debt	732,640	922,030
Other non-current liabilities	182,490	179,463
Total liabilities	1,847,828	2,009,874
Stockholders' equity:		
Common stock, \$.01 par value: 600,000 shares authorized; 95,164 and 94,756 shares issued and outstanding	952	948
Additional paid-in capital	122,861	103,776
Accumulated other comprehensive loss	(83,001 )	(74,974 )
Retained earnings	1,480,054	1,497,766
Unearned ESOP shares	(51,722 )	(65,726 )
Total Patterson Companies, Inc. stockholders' equity	1,469,144	1,461,790
Noncontrolling interests	3,553	—
Total stockholders' equity	1,472,697	1,461,790
Total liabilities and stockholders' equity	\$ 3,320,525	\$ 3,471,664
See accompanying notes		

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

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Net sales	\$1,396,745	\$1,375,222	\$4,137,817	\$4,065,074
Cost of sales	1,097,236	1,080,486	3,259,569	3,155,547
Gross profit	299,509	294,736	878,248	909,527
Operating expenses	254,146	244,690	787,155	730,889
Operating income	45,363	50,046	91,093	178,638
Other income (expense):				
Other income, net	1,427	2,096	8,621	4,768
Interest expense	(9,172)	(11,783)	(29,849)	(34,454)
Income before taxes	37,618	40,359	69,865	148,952
Income tax expense (benefit)	6,564	(68,596)	14,674	(31,094)
Net income	31,054	108,955	55,191	180,046
Net loss attributable to noncontrolling interests	(171)	—	(447)	—
Net income attributable to Patterson Companies, Inc.	\$31,225	\$108,955	\$55,638	\$180,046
Earnings per share attributable to Patterson Companies, Inc.:				
Basic	\$0.34	\$1.18	\$0.60	\$1.94
Diluted	\$0.33	\$1.18	\$0.60	\$1.93
Weighted average shares:				
Basic	92,818	91,949	92,677	92,674
Diluted	93,653	92,609	93,347	93,323
Dividends declared per common share	\$0.26	\$0.26	\$0.78	\$0.78
Comprehensive income:				
Net income	\$31,054	\$108,955	\$55,191	\$180,046
Foreign currency translation gain (loss)	3,184	16,475	(9,676)	24,594
Cash flow hedges, net of tax	548	437	1,649	1,312
Comprehensive income	\$34,786	\$125,867	\$47,164	\$205,952
See accompanying notes				

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## PATTERSON COMPANIES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands)

(Unaudited)

	Common Stock		Additional Paid-in Capital	Accumulated		Unearned ESOP Shares	Non-controlling Interests	Total
	Shares	Amount		Other Comprehensive Income (Loss)	Retained Earnings			
Balance at April 29, 2017	96,534	\$ 966	\$ 72,973	\$ (92,669 )	\$ 1,481,234	\$(68,071)	\$ —	\$ 1,394,433
Foreign currency translation	—	—	—	15,824	—	—	—	15,824
Cash flow hedges	—	—	—	1,871	—	—	—	1,871
Net income (loss)	—	—	—	—	200,974	—	—	200,974
Dividends declared	—	—	—	—	(96,964 )	—	—	(96,964 )
Common stock issued and related tax benefits	369	4	12,403	—	—	—	—	12,407
Repurchases of common stock	(2,147 )	(22 )	—	—	(87,478 )	—	—	(87,500 )
Stock based compensation	—	—	18,400	—	—	—	—	18,400
ESOP activity	—	—	—	—	—	2,345	—	2,345
Balance at April 28, 2018	94,756	948	103,776	(74,974 )	1,497,766	(65,726 )	—	1,461,790
Foreign currency translation	—	—	—	(9,676 )	—	—	—	(9,676 )
Cash flow hedges	—	—	—	1,649	—	—	—	1,649
Net income (loss)	—	—	—	—	55,638	—	(447 )	55,191
Dividends declared	—	—	—	—	(73,350 )	—	—	(73,350 )
Common stock issued and related tax benefits	408	4	4,903	—	—	—	—	4,907
Stock based compensation	—	—	14,182	—	—	—	—	14,182
ESOP activity	—	—	—	—	—	14,004	—	14,004
Increase from asset acquisition	—	—	—	—	—	—	4,000	4,000
Balance at January 26, 2019	95,164	\$ 952	\$ 122,861	\$ (83,001 )	\$ 1,480,054	\$(51,722)	\$ 3,553	\$ 1,472,697

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

	Nine Months Ended January 26, 2019	January 27, 2018
Operating activities:		
Net income	\$ 55,191	\$ 180,046
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	33,317	33,672
Amortization	29,108	29,115
Bad debt expense	4,592	4,471
Non-cash employee compensation	22,282	22,999
Deferred income taxes	5,840	(38,299 )
Deferred consideration in securitized receivables	(308,592 )	(37,068 )
Change in assets and liabilities, net of acquired	234,606	(154,923 )
Net cash provided by operating activities	76,344	40,013
Investing activities:		
Additions to property and equipment	(33,926 )	(28,239 )
Collection of deferred purchase price receivables	308,592	37,068
Other investing activities	2,875	10,600
Net cash provided by investing activities	277,541	19,429
Financing activities:		
Dividends paid	(74,731 )	(74,641 )
Repurchases of common stock	—	(87,500 )
Retirement of long-term debt	(244,010 )	(7,377 )
Draw on revolving credit	13,000	120,000
Other financing activities	6,228	7,546
	(299,513 )	(41,972 )

Net cash used in financing activities			
Effect of exchange rate changes on cash	75		5,576
Net change in cash and cash equivalents	54,447		23,046
Cash and cash equivalents at beginning of period	62,984		94,959
Cash and cash equivalents at end of period	\$ 117,431		\$ 118,005
See accompanying notes			



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PATTERSON COMPANIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

(Unaudited)

Note 1. General

Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position of Patterson Companies, Inc. (referred to herein as "Patterson" or in the first person notations "we," "our," and "us") as of January 26, 2019, and our results of operations and cash flows for the periods ended January 26, 2019 and January 27, 2018. Such adjustments are of a normal recurring nature. The results of operations for the three and nine months ended January 26, 2019 are not necessarily indicative of the results to be expected for any other interim period or for the year ending April 27, 2019. These financial statements should be read in conjunction with the financial statements included in our 2018 Annual Report on Form 10-K filed on June 27, 2018.

The unaudited condensed consolidated financial statements include the assets and liabilities of PDC Funding Company, LLC ("PDC Funding"), PDC Funding Company II, LLC ("PDC Funding II") and PDC Funding Company III, LLC ("PDC Funding III"), which are our wholly owned subsidiaries and separate legal entities formed under Minnesota law. PDC Funding and PDC Funding II are fully consolidated special purpose entities established to sell customer installment sale contracts to outside financial institutions in the normal course of their business. PDC Funding III is a fully consolidated special purpose entity established to sell certain receivables to unaffiliated financial institutions. The assets of PDC Funding, PDC Funding II and PDC Funding III would be available first and foremost to satisfy the claims of its creditors. There are no known creditors of PDC Funding, PDC Funding II or PDC Funding III. The unaudited condensed consolidated financial statements also include the assets and liabilities of Technology Partner Innovations, LLC, which is further described in Note 7.

Fiscal Year End

We operate with a 52-53 week accounting convention with our fiscal year ending on the last Saturday in April. The third quarter of fiscal 2019 and 2018 represents the 13 weeks ended January 26, 2019 and the 13 weeks ended January 27, 2018, respectively. The nine months ended January 26, 2019 and January 27, 2018 each included 39 weeks. Fiscal 2019 will include 52 weeks and fiscal 2018 included 52 weeks.

Comprehensive Income

Comprehensive income is computed as net income including certain other items that are recorded directly to stockholders' equity. Significant items included in comprehensive income are foreign currency translation adjustments and the effective portion of cash flow hedges, net of tax. Foreign currency translation adjustments do not include a provision for income tax because earnings from foreign operations are considered to be indefinitely reinvested outside the U.S. The income tax expense related to cash flow hedges was \$177 and \$265 for the three months ended January 26, 2019 and January 27, 2018, respectively. The income tax expense related to cash flow hedges was \$534 and \$795 for the nine months ended January 26, 2019 and January 27, 2018, respectively.

Earnings Per Share

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

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	Three Months Ended		Nine Months Ended	
	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Denominator for basic EPS – weighted average shares	92,818	91,949	92,677	92,674
Effect of dilutive securities – stock options, restricted stock and stock purchase plans	835	660	670	649
Denominator for diluted EPS – weighted average shares	93,653	92,609	93,347	93,323

Potentially dilutive securities representing 1,853 and 1,764 shares for the three and nine months ended January 26, 2019, respectively, and 1,568 and 1,354 shares for the three and nine months ended January 27, 2018, respectively, were excluded from the calculation of diluted EPS because their effects were anti-dilutive using the treasury stock method.

**Revenue Recognition**

Revenues are generated from the sale of consumable products, equipment and support, software and support, technical service parts and labor, and other sources. Revenues are recognized when or as performance obligations are satisfied. Performance obligations are satisfied when the customer obtains control of the goods or services.

Consumable, equipment, software and parts sales are recorded upon delivery, except in those circumstances where terms of the sale are FOB shipping point, in which case sales are recorded upon shipment. Technical service labor is recognized as it is provided. Revenue derived from equipment and software support is recognized ratably over the period in which the support is provided.

In addition to revenues generated from the distribution of consumable products under arrangements (buy/sell agreements) where the full market value of the product is recorded as revenue, we earn commissions for services provided under agency agreements. The agency agreement contrasts to a buy/sell agreement in that we do not have control over the transaction, as we do not have the primary responsibility of fulfilling the promise of the good or service and we do not bill or collect from the customer in an agency relationship. Commissions under agency agreements are recorded when the services are provided.

Estimates for returns, damaged goods, rebates, loyalty programs and other revenue allowances are made at the time the revenue is recognized based on the historical experience for such items. The receivables that result from the recognition of revenue are reported net of related allowances. We maintain a valuation allowance based upon the expected collectability of receivables held. Estimates are used to determine the valuation allowance and are based on several factors, including historical collection data, economic trends and credit worthiness of customers. Receivables are written off when we determine the amounts to be uncollectible, typically upon customer bankruptcy or non-response to continuous collection efforts. The portions of receivable amounts that are not expected to be collected during the next twelve months are classified as long-term.

Net sales do not include sales tax as we are considered a pass-through conduit for collecting and remitting sales tax.

**Contract Balances**

Contract balances represent amounts presented in our condensed consolidated balance sheets when either we have transferred goods or services to the customer or the customer has paid consideration to us under the contract. These contract balances include accounts receivable, contract assets and contract liabilities.

Contract asset balances as of January 26, 2019 and April 28, 2018 were not material. Our contract liabilities primarily relate to advance payments from customers, upfront payments for software and support provided over time, and options that provide a material right to customers, such as our customer loyalty programs. At January 26, 2019 and April 28, 2018, contract liabilities of \$26,416 and \$26,166 were reported in other accrued liabilities, respectively. During the nine months ended January 26, 2019, we recognized \$24,819 of the amount previously deferred at April 28, 2018.

**Recently Issued Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". ASU No. 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)," and requires entities to recognize revenue in a way



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that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. We adopted the new guidance as of April 29, 2018 using the modified retrospective method, and the adoption had no impact on our consolidated net earnings, financial position, or cash flows.

In January 2016, the FASB issued ASU No. 2016-01 "Financial Instruments- Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)", which amends certain aspects of recognition, measurement, presentation and disclosure of financial instruments, including the requirement to measure certain equity investments at fair value with changes in fair value recognized in net income. We adopted ASU No. 2016-01 in the first quarter of fiscal 2019, and the adoption had no impact on our consolidated net earnings, financial position, or cash flows.

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

In February 2018, the FASB issued ASU No. 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income," which will allow a reclassification from accumulated other comprehensive income to retained earnings for the tax effects that are stranded in accumulated other comprehensive income as a result of tax reform. This standard also requires certain disclosures about stranded tax effects. We will adopt ASU No. 2018-02 in the first quarter of fiscal 2020, and apply it either in the period of adoption or retrospectively to each period in which the income tax effects of the tax reform related to items in accumulated other comprehensive income are recognized. We are currently evaluating the impact of adopting this pronouncement.

### Note 2. Receivables Securitization Program

On July 24, 2018, we entered into a Receivables Purchase Agreement (the "Receivables Purchase Agreement") with MUFG Bank, Ltd. ("MUFG") (f.k.a. The Bank of Tokyo-Mitsubishi UFJ, Ltd.). Under this agreement, MUFG acts as an agent to facilitate the sale of certain Patterson receivables (the "Receivables") to certain unaffiliated financial institutions (the "Purchasers"). The sale of these receivables is accounted for as a sale of assets under the provisions of ASC 860, Transfers and Servicing. We utilize PDC Funding III to facilitate the sale to fulfill requirements within the agreement.

Sales of Receivables occur daily and are settled with the Purchasers on a monthly basis. The proceeds from the sale of these Receivables comprise a combination of cash and a deferred purchase price ("DPP") receivable. The DPP receivable is ultimately realized by Patterson following the collection of the underlying Receivables sold to the Purchasers. The amount available under the Receivables Purchase Agreement fluctuates over time based on the total amount of eligible Receivables generated during the normal course of business, with maximum availability of \$200,000. As of January 26, 2019, \$167,000 of the amount available under the Receivables Purchase Agreement was utilized.

We have no retained interests in the transferred Receivables, other than our right to the DPP receivable and collection and administrative service fees. We consider the fees received adequate compensation for services rendered, and accordingly have recorded no servicing asset or liability. The DPP receivable is recorded at fair value within the condensed consolidated balance sheets within prepaid expenses and other current assets. The DPP receivable was \$58,322 as of January 26, 2019. The difference between the carrying amount of the Receivables and the sum of the cash and fair value of the DPP receivable received at time of transfer is recognized as a gain or loss on sale of the related Receivables. We recorded a loss on sale of Receivables within operating expenses in the condensed consolidated statements of income and other comprehensive income during the three and nine months ended January 26, 2019 of \$2,719 and \$5,590, respectively.

### Note 3. Customer Financing

As a convenience to our customers, we offer several different financing alternatives, including a third party program and a Patterson-sponsored program. For the third party program, we act as a facilitator between the customer and the third party financing entity with no on-going involvement in the financing transaction. Under the Patterson-sponsored program, equipment purchased by creditworthy customers may be financed up to a maximum of \$1,000. We generally

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sell our customers' financing contracts to outside financial institutions in the normal course of our business. These financing arrangements are accounted for as a sale of assets under the provisions of ASC 860, Transfers and Servicing. We currently have two arrangements under which we sell these contracts.

First, we operate under an agreement to sell a portion of our equipment finance contracts to commercial paper conduits with MUFG serving as the agent. We utilize PDC Funding to fulfill a requirement of participating in the commercial paper conduit. We receive the proceeds of the contracts upon sale to MUFG. At least 9.5% of the proceeds are held by the conduit as security against eventual performance of the portfolio. This percentage can be greater and is based upon certain ratios defined in the agreement with MUFG. The capacity under the agreement with MUFG at January 26, 2019 was \$525,000.

Second, we maintain an agreement with Fifth Third Bank ("Fifth Third") whereby Fifth Third purchases customers' financing contracts. PDC Funding II sells its financing contracts to Fifth Third. We receive the proceeds of the contracts upon sale to Fifth Third. At least 11.0% of the proceeds are held by the conduit as security against eventual performance of the portfolio. This percentage can be greater and is based upon certain ratios defined in the agreement with Fifth Third. The capacity under the agreement with Fifth Third at January 26, 2019 was \$100,000.

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

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

During the three months ended January 26, 2019 and January 27, 2018, we sold \$107,715 and \$45,361 of contracts under these arrangements, respectively. During the nine months ended January 26, 2019 and January 27, 2018, we sold \$195,738 and \$197,072 of contracts under these arrangements, respectively. In net sales in the condensed consolidated statements of income and other comprehensive income, we recorded a gain of \$6,641 during the three months ended January 26, 2019 and a loss of \$1,688 during the three months ended January 27, 2018 related to these contracts sold. In net sales in the condensed consolidated statements of income and other comprehensive income, we recorded a gain of \$11,866 and \$8,539 during the nine months ended January 26, 2019 and January 27, 2018, respectively, related to these contracts sold.

Included in cash and cash equivalents in the condensed consolidated balance sheets are \$33,850 and \$35,741 as of January 26, 2019 and April 28, 2018, respectively, which represent cash collected from previously sold customer financing contracts that have not yet been settled. Included in current receivables in the condensed consolidated balance sheets are \$69,772, net of unearned income of \$41, and \$46,232, net of unearned income of \$8, as of January 26, 2019 and April 28, 2018, respectively, of finance contracts we have not yet sold. A total of \$571,664 of finance contracts receivable sold under the arrangements was outstanding at January 26, 2019. The DPP receivable under the arrangements was \$111,461 and \$150,404 as of January 26, 2019 and April 28, 2018, respectively. Since the internal financing program began in 1994, bad debt write-offs have amounted to less than 1% of the loans originated. The arrangements require us to maintain a minimum current ratio and maximum leverage ratio. We were in compliance with those covenants at January 26, 2019.

#### Note 4. Derivative Financial Instruments

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

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



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As of January 26, 2019, PDC Funding had purchased an interest rate cap from a bank with a notional amount of \$525,000 and a maturity date of July 2026. We sold an identical interest rate cap to the same bank. As of January 26, 2019, PDC Funding II had purchased an interest rate cap from a bank with a notional amount of \$100,000 and a maturity date of December 2025. We sold an identical interest rate cap to the same bank.

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

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

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

In January 2019, we entered into a forward interest rate swap agreement with a notional amount of \$539,400 in order to hedge against interest rate fluctuations that impact the amount of net sales we record related to our customer financing contracts. This interest rate swap does not qualify for hedge accounting treatment and, accordingly, we will record the fair value of the agreements as an asset or liability and the change as income or expense during the period in which the change occurs.

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

Derivative type	Classification	January April	
		26, 2019	28, 2018
Assets:			
Interest rate contracts	Other non-current assets	\$ 1,169	\$ 1,613
Liabilities:			
Interest rate contracts	Other accrued liabilities	28	—
Interest rate contracts	Other non-current liabilities	1,425	1,613
Total liability derivatives		\$ 1,453	\$ 1,613

The following tables present the pre-tax effect of derivative instruments on the condensed consolidated statements of income:

Derivatives in cash flow hedging relationships	Income statement location	Amount of Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)			
		Three Months Ended		Nine Months Ended	
		January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Interest rate contracts	Interest expense	\$(725)	\$(702)	\$(2,183)	\$(2,107)



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		Amount of Gain (Loss) Recognized in Income on Derivative			
		Three Months Ended		Nine Months Ended	
Derivatives not designated as hedging instruments	Income statement location	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Interest rate contracts	Other income, net	\$(284)	\$	—\$(284)	\$

There were no gains or losses recognized in OCI on cash flow hedging derivatives during the three and nine months ended January 26, 2019 or January 27, 2018.

We recorded no ineffectiveness during the three and nine month periods ended January 26, 2019 and January 27, 2018. As of January 26, 2019, the estimated pre-tax portion of accumulated other comprehensive loss that is expected to be reclassified into earnings over the next twelve months is \$2,900, which will be recorded as an increase to interest expense.

#### Note 5. Fair Value Measurements

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

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

Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and

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

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

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

	January 26, 2019			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents	\$1,895	\$1,895	\$—	\$—
DPP receivable - receivables securitization program	58,322	—	—	58,322
DPP receivable - customer financing	111,461	—	—	111,461
Derivative instruments	1,169	—	1,169	—
Total assets	\$172,847	\$1,895	\$1,169	\$169,783
Liabilities:				
Derivative instruments	\$1,453	\$—	\$1,453	\$—

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	April 28, 2018			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents	\$6,650	\$6,650	\$—	\$—
DPP receivable - receivables securitization program	—	—	—	—
DPP receivable - customer financing	150,404	—	—	150,404
Derivative instruments	1,613	—	1,613	—
Total assets	\$158,667	\$6,650	\$1,613	\$150,404
Liabilities:				
Derivative instruments	\$1,613	\$—	\$1,613	\$—

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

DPP receivable - receivables securitization program – We value this DPP receivable based on a discounted cash flow analysis using unobservable inputs, which include the estimated timing of payments and the credit quality of the underlying creditor. Significant changes in any of the significant unobservable inputs in isolation would not result in a materially different fair value estimate. The interrelationship between these inputs is insignificant.

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

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

Certain assets are measured at fair value on a non-recurring basis. These assets are not measured at fair value on an ongoing basis, but are subject to fair value adjustments under certain circumstances, such as when there is evidence of impairment. There were no fair value adjustments to such assets during the nine month periods ended January 26, 2019 or January 27, 2018.

Our debt is not measured at fair value in the condensed consolidated balance sheets. The estimated fair value of our debt as of January 26, 2019 and April 28, 2018 was \$745,533 and \$989,124, respectively, as compared to a carrying value of \$754,771 and \$998,628 at January 26, 2019 and April 28, 2018, respectively. The fair value of debt was measured using a discounted cash flow analysis based on expected market based yields (i.e., Level 2 inputs).

The carrying amounts of receivables, net of allowances, accounts payable, and certain accrued and other current liabilities approximated fair value at January 26, 2019 and April 28, 2018.

#### Note 6. Income Taxes

The effective income tax rate for the three months ended January 26, 2019 was 17.4% compared to (170.0)% for the three months ended January 27, 2018, and for the nine months ended January 26, 2019 was 21.0% compared to (20.9)% for the nine months ended January 27, 2018.

The change in tax rate for the three and nine months ended January 26, 2019 compared to the three and nine months ended January 27, 2018 was primarily due to the impact of the Tax Cuts and Jobs Act ("Tax Act"), enacted on December 22, 2017 by the U.S. government. The Tax Act significantly revises the future ongoing U.S. federal corporate income tax by, among other things, lowering U.S. federal corporate tax rates and implementing a territorial tax system. Effective January 1, 2018, the Tax Act reduced the U.S. federal corporate tax rate from 35.0% to 21.0%. For the fiscal year ended April 28, 2018, we utilized a blended rate of approximately 30.5%. For the three and nine months ended January 26, 2019, we utilized a 21.0% U.S. federal statutory rate.

The legislative changes included in the Tax Act are broad and complex. For the fiscal year ended April 28, 2018, we recognized provisional net tax benefit of \$76,648, which included provisional amounts of \$81,871 of tax benefit on

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U.S. deferred tax assets and liabilities, \$4,006 of tax expense for a one-time transition tax on unremitted foreign earnings and \$1,217 in withholding taxes paid on current year distributions. During the nine months ended January 26, 2019, we completed our accounting for the previously recorded provisional impacts of the Tax Act and recorded additional remeasurement benefit of \$2,355 on U.S. deferred tax assets and liabilities and a reduction to the transition tax cost of \$331.

For the fiscal year ended April 28, 2018, and directly connected to the transition tax legislation, Patterson approved a one-time repatriation of cash included in the transition tax computation. There was an approximate \$1,217 one-time cost recorded during fiscal 2018 to reflect the added withholding tax cost associated with this repatriation. With the exception of this one-time repatriation, Patterson continues to apply ASC 740 based on the provisions of the tax law that were in effect immediately prior to the enactment of the new law. With regard to unremitted earnings of foreign subsidiaries generated after December 31, 2017, we do not currently provide for U.S. taxes since we intend to invest such undistributed earnings indefinitely outside of the U.S.

We have made an accounting policy election to treat the impacts of the global intangible low taxed income (“GILTI”) tax as a period cost in the period incurred. An estimate of GILTI has been included in the effective tax rate for the three and nine months ended January 26, 2019. We continue to monitor this estimate as the GILTI provisions under the Tax Act are complex and subject to continued regulatory interpretation by the IRS.

While we have completed our accounting for the previously recorded provisional impacts of the Tax Act, pursuant to the Securities and Exchange Commission rules, under SAB 118, changes in interpretations of the Tax Act, analysis of proposed and final regulations as they are issued, current and additional guidance from the Internal Revenue Service and/or state legislative actions as well as potential changes in accounting standards surrounding income taxes and the Tax Act may result in further, potentially material, changes to these completed computations.

Note 7. Technology Partner Innovations, LLC

In the first quarter of fiscal 2019, we entered into an agreement with Cure Partners to form Technology Partner Innovations, LLC (TPI), which is launching a new cloud-based practice management software, NaVetor. Patterson and Cure Partners each contributed net assets of \$4,000 to form TPI. We have determined that TPI is a variable interest entity, and we consolidate the results of operations of TPI as we have concluded that we are the primary beneficiary of TPI. During the three and nine ended January 26, 2019, net loss attributable to the noncontrolling interest was \$171 and \$447, respectively, resulting in noncontrolling interests of \$3,553 on the condensed consolidated balance sheet at January 26, 2019.

Note 8. Segment and Geographic Data

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

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The following tables present information about our reportable segments:

	Three Months Ended		Nine Months Ended	
	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
<b>Consolidated net sales</b>				
United States	\$1,170,446	\$1,150,650	\$3,440,533	\$3,382,357
United Kingdom	141,877	137,404	446,234	426,992
Canada	84,422	87,168	251,050	255,725
Total	\$1,396,745	\$1,375,222	\$4,137,817	\$4,065,074
<b>Dental net sales</b>				
United States	\$529,522	\$525,934	\$1,478,552	\$1,493,425
Canada	50,211	51,943	149,761	156,889
Total	\$579,733	\$577,877	\$1,628,313	\$1,650,314
<b>Animal Health net sales</b>				
United States	\$631,407	\$622,238	\$1,940,594	\$1,868,758
United Kingdom	141,877	137,404	446,234	426,992
Canada	34,211	35,225	101,289	98,836
Total	\$807,495	\$794,867	\$2,488,117	\$2,394,586
<b>Corporate net sales</b>				
United States	\$9,517	\$2,478	\$21,387	\$20,174
Total	\$9,517	\$2,478	\$21,387	\$20,174
	Three Months Ended		Nine Months Ended	
	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
<b>Consolidated net sales</b>				
Consumable	\$1,079,566	\$1,074,189	\$3,327,214	\$3,270,385
Equipment and software	234,251	222,574	563,269	540,860
Other	82,928	78,459	247,334	253,829
Total	\$1,396,745	\$1,375,222	\$4,137,817	\$4,065,074
<b>Dental net sales</b>				
Consumable	\$294,708	\$302,296	\$902,753	\$933,691
Equipment and software	217,649	207,000	520,292	504,376
Other	67,376	68,581	205,268	212,247
Total	\$579,733	\$577,877	\$1,628,313	\$1,650,314
<b>Animal Health net sales</b>				
Consumable	\$784,858	\$771,893	\$2,424,461	\$2,336,694
Equipment and software	16,602	15,574	42,977	36,484
Other	6,035	7,400	20,679	21,408
Total	\$807,495	\$794,867	\$2,488,117	\$2,394,586
<b>Corporate net sales</b>				
Other	\$9,517	\$2,478	\$21,387	\$20,174
Total	\$9,517	\$2,478	\$21,387	\$20,174

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	Three Months Ended		Nine Months Ended	
	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Operating income (loss)				
Dental	\$51,120	\$ 58,439	\$ 128,587	\$ 183,165
Animal Health	15,033	18,037	56,096	57,930
Corporate	(20,790 )	(26,430 )	(93,590 )	(62,457 )
Consolidated operating income	\$45,363	\$ 50,046	\$91,093	\$ 178,638
	January 26, April 28, 2019	2018		
Total assets				
Dental	\$679,790	\$853,555		
Animal Health	2,172,044	2,128,800		
Corporate	468,691	489,309		
Total assets	\$3,320,525	\$3,471,664		

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

The following table summarizes the changes in AOCL as of January 26, 2019:

	Cash Flow Hedges	Currency Translation Adjustment	Total
AOCL at April 28, 2018	\$(13,118 )	\$(61,856 )	\$(74,974)
Other comprehensive loss before reclassifications	—	(9,676 )	(9,676 )
Amounts reclassified from AOCL	1,649	—	1,649
AOCL at January 26, 2019	\$(11,469 )	\$(71,532 )	\$(83,001)

The amounts reclassified from AOCL during fiscal 2019 represent gains and losses on cash flow hedges, net of taxes of \$534. The impact to the condensed consolidated statements of income and other comprehensive income was an increase to interest expense of \$2,183.

## Note 10. Legal Proceedings

In September 2015, we were served with a summons and complaint in an action commenced in the U.S. District Court for the Eastern District of New York, entitled SourceOne Dental, Inc. v. Patterson Companies, Inc., Henry Schein, Inc. and Benco Dental Supply Company, Civil Action No. 15-cv-05440-JMA-GRB. SourceOne, as plaintiff, alleges that, through its website, it markets and sells dental supplies and equipment to dentists. SourceOne alleges in the complaint, among other things, that we, along with the defendants Henry Schein and Benco, conspired to eliminate plaintiff as a competitor and to exclude them from the market for the marketing, distribution and sale of dental supplies and equipment in the U.S. and that defendants unlawfully agreed with one another to boycott dentists, manufacturers, and state dental associations that deal with, or considered dealing with, plaintiff. Plaintiff asserts the following claims: (i) unreasonable restraint of trade in violation of state and federal antitrust laws; (ii) tortious interference with prospective business relations; (iii) civil conspiracy; and (iv) aiding and abetting the other defendants' ongoing tortious and anticompetitive conduct. Plaintiff seeks equitable relief, compensatory and treble damages, jointly and severally, punitive damages, interest, and reasonable costs and expenses, including attorneys' fees and expert fees. In June 2017, Henry Schein settled with SourceOne and was dismissed from this litigation with prejudice. We are vigorously defending ourselves in this litigation. Trial is scheduled to begin on April 29, 2019. We do not anticipate that this matter will have a material adverse effect on our financial statements.

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Beginning in January 2016, purported antitrust class action complaints were filed against defendants Henry Schein, Inc., Benco Dental Supply Company and Patterson Companies, Inc. Although there were factual and legal variations among these complaints, each alleged that defendants conspired to foreclose and exclude competitors by boycotting manufacturers, state dental associations, and others that deal with defendants' competitors. On February 9, 2016, the U.S. District Court for the Eastern District of New York ordered all of these actions, and all other actions filed thereafter asserting substantially similar claims against defendants, consolidated for pre-trial purposes. On February 26, 2016, a consolidated class action complaint was filed by Arnell Prato, D.D.S., P.L.L.C., d/b/a Down to Earth Dental, Evolution Dental Sciences, LLC, Howard M. May, DDS, P.C., Casey Nelson, D.D.S., Jim Peck, D.D.S., Bernard W. Kurek, D.M.D., Larchmont Dental Associates, P.C., and Keith Schwartz, D.M.D., P.A. (collectively, "putative class representatives") in the U.S. District Court for the Eastern District of New York, entitled *In re Dental Supplies Antitrust Litigation*, Civil Action No. 1:16-CV-00696-BMC-GRB. Subject to certain exclusions, the putative class representatives seek to represent all private dental practices and laboratories who purchased dental supplies or equipment in the U.S. directly from any of the defendants, during the period beginning August 31, 2008 until March 31, 2016. In the consolidated class action complaint, putative class representatives allege a nationwide agreement among Henry Schein, Benco, Patterson and non-party Burkhardt Dental Supply Company, Inc. not to compete on price. The consolidated class action complaint asserts a single count under Section 1 of the Sherman Act, and seeks equitable relief, compensatory and treble damages, jointly and severally, interest, and reasonable costs and expenses, including attorneys' fees and expert fees. On September 28, 2018, the parties executed a settlement agreement that proposes, subject to court approval, a full and final settlement of the lawsuit on a class-wide basis. Subject to certain exceptions, the settlement class consists of all persons or entities that purchased dental products directly from Henry Schein, Patterson, Benco and Burkhardt, or any combination thereof, during the period August 31, 2008 through and including March 31, 2016. As a result, we recorded a charge of \$28,263 in our first quarter 2019 results in our Corporate segment.

On August 31, 2012, Archer and White Sales, Inc. ("Archer") filed a complaint against Henry Schein, Inc. as well as Danaher Corporation and its subsidiaries Instrumentarium Dental, Inc., Dental Equipment, LLC, Kavo Dental Technologies, LLC and Dental Imaging Technologies Corporation (collectively, the "Danaher Defendants") in the United States District Court for the Eastern District of Texas, Civil Action No. 2:12-CV-00572-JRG, styled as an antitrust action under Section 1 of the Sherman Act, and the Texas Free Enterprise Antitrust Act. Archer alleges a conspiracy between Henry Schein, an unnamed company and the Danaher Defendants to terminate or limit Archer's distribution rights. On August 1, 2017, Archer filed an amended complaint, adding Patterson Companies, Inc. and Benco Dental Supply Company as defendants, and alleging that Henry Schein, Patterson, Benco and non-defendant Burkhardt Dental Supply Company, Inc. conspired to pressure and agreed to enlist their common suppliers, including the Danaher Defendants, to join a price-fixing conspiracy and boycott by reducing the distribution territory of, and eventually terminating, Archer. Archer seeks injunctive relief, and damages in an amount to be proved at trial, to be trebled with interest and costs, including attorneys' fees, jointly and severally. On June 25, 2018, the United States Supreme Court granted certiorari to review an arbitration issue raised by the Danaher Defendants, thereby continuing the case stay implemented in March 2018. On October 29, 2018, the Supreme Court heard oral arguments. On January 8, 2019, the Supreme Court issued its published decision vacating the judgment of the U.S. Court of Appeals for the Fifth Circuit and remanding the case to the Fifth Circuit for further proceedings on a second arbitration issue consistent with the Supreme Court's opinion. We are vigorously defending ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial statements.

On August 17, 2017, IQ Dental Supply, Inc. ("IQ Dental") filed a complaint in the United States District Court for the Eastern District of New York, entitled *IQ Dental Supply, Inc. v. Henry Schein, Inc., Patterson Companies, Inc. and Benco Dental Supply Company*, Case No. 2:17-cv-4834. Plaintiff alleges that it is a distributor of dental supplies and equipment, and sells dental products through an online dental distribution platform operated by SourceOne Dental, Inc. IQ Dental alleges, among other things, that defendants conspired to suppress competition from IQ Dental and SourceOne for the marketing, distribution and sale of dental supplies and equipment in the United States, and that defendants unlawfully agreed with one another to boycott dentists, manufacturers and state dental associations that

deal with, or considered dealing with, plaintiff and SourceOne. Plaintiff claims that this alleged conduct constitutes unreasonable restraint of trade in violation of Section 1 of the Sherman Act, New York's Donnelly Act and the New Jersey Antitrust Act, and also makes pendant state law claims for tortious interference with prospective business relations, civil conspiracy and aiding and abetting. Plaintiff seeks injunctive relief, compensatory, treble and punitive damages, jointly and severally, and reasonable costs and expenses, including attorneys' fees and expert fees. On December 21, 2017, the District Court granted defendants motion to dismiss the complaint with prejudice. Plaintiff has appealed the District Court's order. The U.S. Court of Appeals for the Second Circuit heard oral argument on the appeal on September 13, 2018. The court's decision is pending. We are vigorously defending ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial statements.

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On February 12, 2018, the Federal Trade Commission (“FTC”) issued an administrative complaint entitled In the Matter of Benco Dental Supply Co., Henry Schein, Inc., and Patterson Companies, Inc. Docket No. 9379. The administrative complaint alleges “reason to believe” that Patterson and the other respondents violated Section 5 of the FTC Act, 15 U.S.C. § 45 by conspiring to refuse to offer discounted prices or otherwise negotiate with buying groups seeking to obtain supply agreements on behalf of groups of solo practitioners or small group dental practices. The administrative complaint seeks injunctive relief against Patterson, including an order to cease and desist from the conduct alleged in the complaint and a prohibition from conspiring or agreeing with any competitor or any person to refuse to provide discounts to or compete for the business of any customer. No money damages are sought. We are vigorously defending ourselves against the administrative complaint. The hearing in front of an Administrative Law Judge of the FTC in Washington, D.C. began on October 16, 2018. The factual record closed on February 21, 2019 and the parties are in the process of post-trial briefing before the Administration Law Judge. We do not anticipate this matter will have a material adverse effect on our financial statements.

On March 28, 2018, Plymouth County Retirement System (“Plymouth”) filed a federal securities class action complaint against Patterson Companies, Inc. and its former CEO Scott P. Anderson and former CFO Ann B. Gugino in the U.S. District Court for the District of Minnesota in a case captioned Plymouth County Retirement System v. Patterson Companies, Inc., Scott P. Anderson and Ann B. Gugino, Case No. 0:18-cv-00871 MJD/SER. On November 9, 2018, the complaint was amended to add former CEO James W. Wiltz and former CFO R. Stephen Armstrong as individual defendants. Under the amended complaint, on behalf of all persons or entities that purchased or otherwise acquired Patterson’s common stock between June 26, 2013 and February 28, 2018, Plymouth alleges that Patterson violated federal securities laws by failing to disclose that Patterson’s revenue and earnings were “artificially inflated by Defendants’ illicit, anti-competitive scheme with its purported competitors, Benco and Schein, to prevent the formation of buying groups that would allow its customers who were office-based practitioners to take advantage of pricing arrangements identical or comparable to those enjoyed by large-group customers.” In its class action complaint, Plymouth asserts one count against Patterson for violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and a second, related count against the individual defendants for violating Section 20(a) of the Exchange Act. Plymouth seeks compensatory damages, pre- and post-judgment interest and reasonable attorneys’ fees and experts’ witness fees and costs. On August 30, 2018, Gwinnett County Public Employees Retirement System and Plymouth County Retirement System, Pembroke Pines Pension Fund for Firefighters and Police Officers, Central Laborers Pension Fund were appointed lead plaintiffs. While the outcome of litigation is inherently uncertain, we believe that the class action complaint is without merit, and we are vigorously defending ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial statements. Patterson has also received requests under Minnesota Business Corporation Act § 302A.461 to inspect corporate books and records relating to the issues raised in the securities class action and the antitrust matters discussed above.

During the first quarter of fiscal 2019, the U.S. Attorney’s Office for the Western District of Virginia informed us that our subsidiary, Animal Health International, Inc., has been designated a target of a criminal investigation. The investigation relates to Animal Health International sales of prescription animal health products to certain persons and/or locations not licensed to receive them in Virginia and Tennessee in violation of federal and state laws. In October 2018, we entered into a three-month tolling agreement, which was subsequently extended to July 31, 2019, to allow us to produce documents responsive to grand jury subpoenas and to allow for further evaluation of evidence. In December 2018, as a result of our ongoing internal investigation, we advised the U.S. Attorney’s Office of our shipments of prescription animal health products that were made from a warehouse rather than a pharmacy in the states of Virginia and Tennessee. We have modified our shipment processes and are continuing to evaluate the need for further modification. We continue to cooperate with the U.S. Attorney’s Office on this matter. At this time, we are unable to make an estimate of the amount of loss, if any, or range of possible loss that we could incur as a result of the foregoing matter.



On August 28, 2018, Kirsten Johnsen filed a stockholder derivative complaint against Patterson Companies, Inc., as a nominal defendant, and the following former and current officers and directors of Patterson: Scott Anderson, Ann Gugino, James Wiltz, John Buck, Jody Feragen, Ellen Rudnick, Les Vinney, Neil Schrimsher, Sarena Lin, Harold Slavkin, Alex Blanco and Mark Walchirk as individual defendants in Hennepin County District Court in a case captioned Kirsten Johnsen v. Scott P. Anderson et al., Case No. 27-CV-18-14315. Derivatively on behalf of Patterson, plaintiff alleges that Patterson “suppressed price competition and maintained supracompetitive prices for dental supplies and equipment by entering into agreements with Henry Schein and Benco to: (i) fix margins for dental supplies and equipment; and (ii) block the entry and expansion of lower-margin, lower-priced, rival dental distributors through threatened and actual group boycotts.” Plaintiff further alleges that the individual defendants failed to disclose Patterson’s alleged “price-fixing scheme” to the public and purportedly “caused Patterson to repurchase over \$412,800

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worth of its own stock at artificially inflated prices.” In the derivative complaint, plaintiff asserts three counts against the individual defendants for: (i) breach of fiduciary duty; (ii) waste of corporate assets; and (iii) unjust enrichment. Plaintiff seeks compensatory damages, equitable and injunctive relief as permitted by law, costs, disbursements and reasonable attorneys’ fees, accountants’ fees and experts’ fees, costs and expenses, and an order awarding restitution from the individual defendants and directing Patterson “to take all necessary actions to reform and improve its corporate governance and internal procedures.” On February 19, 2019, the court ordered this litigation stayed pending resolution of the below-described case brought by Sally Pemberton. While the outcome of litigation is inherently uncertain, we believe that the derivative complaint is without merit, and we intend to vigorously defend ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial statements.

On October 1, 2018, Sally Pemberton filed a stockholder derivative complaint against Patterson Companies, Inc., as a nominal defendant, and the following former and current officers and directors of Patterson: Scott Anderson, Ann Gugino, Mark Walchirk, John Buck, Alex Blanco, Jody Feragen, Sarena Lin, Ellen Rudnick, Neil Schrimsher, Les Vinney, James Wiltz, Paul Guggenheim, David Misiak and Tim Rogan as individual defendants in the United States District Court for the District of Minnesota in a case captioned Sally Pemberton v. Scott P. Anderson, et al., Case No. 18-CV-2818. Derivatively on behalf of Patterson, plaintiff alleges that Patterson, with Benco and Henry Schein, “engage[d] in a conspiracy in restraint of trade, whereby the companies agreed to refuse to offer discounted prices or otherwise negotiate with GPOs, agreed to fix margins on dental supplies and equipment, agreed not to poach one another’s customers or sales representatives, and agreed to block the entry and expansion of rival distributors. Plaintiff further alleges that the individual defendants failed to disclose Patterson’s alleged “antitrust misconduct” to the public and purportedly caused Patterson to repurchase \$412,800 of its own stock at prices that were artificially inflated. In the derivative complaint, plaintiff asserts six counts against the individual defendants for: (i) breach of fiduciary duty; (ii) waste of corporate assets; (iii) unjust enrichment; (iv) violations of Section 14(a) of the Exchange Act; (v) violations of Section 10(b) and Rule 10b-5 of the Exchange Act and (vi) violations of Section 20(a) of the Exchange Act. Plaintiff seeks compensatory damages with pre-judgment and post-judgment interest, costs, disbursements and reasonable attorneys’ fees, experts’ fees, costs and expenses, and an order awarding restitution from the individual defendants and directing Patterson “to take all necessary actions to reform and improve its corporate governance and internal procedures.” While the outcome of litigation is inherently uncertain, we believe that the derivative complaint is without merit, and we intend to vigorously defend ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial statements.

On October 9, 2018, Nathaniel Kramer filed indirect purchaser litigation against Patterson Companies, Inc., Henry Schein, Inc. and Benco Dental Supply Company in the United States District Court for the District of Northern District of California. The purported class action complaint asserts violations of the California Cartwright Act and the California Unfair Competition Act based on an alleged agreement between Schein, Benco, and Patterson (and unnamed co-conspirators) not to compete as to price and margins. Plaintiff alleges that the agreement allowed the defendants to charge higher prices to dental practices for dental supplies and that the dental practices passed on all, or part of, the increased prices to the consumers of dental services. Subject to certain exclusions, the complaint defines the class as all persons residing in California purchasing and/or reimbursing for dental services from California dental practices. The complaint seeks a permanent injunction, actual damages to be determined at trial, trebled, reasonable attorneys’ fees and costs, and pre- and post-judgment interest. On December 7, 2018, an amended complaint was filed asserting the same claims against the same parties. While the outcome of litigation is inherently uncertain, we believe that the indirect purchaser action is without merit, and we intend to vigorously defend ourselves in this litigation.

On January 29, 2019, a purported class action complaint was filed by R. Lawrence Hatchett, M.D. against Patterson Companies, Inc., Henry Schein, Inc., Benco Dental Supply Company, and unnamed co-conspirators in the U.S. District Court for the Southern District of Illinois. The complaint alleges that members of the proposed class suffered antitrust injury due to an unlawful boycott, price-fixing or otherwise anticompetitive conspiracy among Schein, Benco and Patterson. The complaint alleges that the alleged conspiracy overcharged Illinois dental practices, orthodontic practices and dental laboratories on their purchase of dental supplies, which in turn passed on some or all of such

overcharges to members of the class. Subject to certain exclusions, the complaint defines the class as all persons residing in Illinois purchasing and/or reimbursing for dental care provided by independent Illinois dental practices purchasing dental supplies from the defendants, or purchasing from buying groups purchasing these supplies from the defendants, on or after January 29, 2015. The complaint alleges violations of the Illinois Antitrust Act, 740 Ill. Comp. Stat. §§ 10/3(2), 10/7(2), and seeks a permanent injunction, actual damages to be determined at trial, trebled, reasonable attorneys' fees and costs, and pre- and post-judgment interest. While the outcome of litigation is inherently uncertain, we believe that the indirect purchaser action is without merit, and we intend to vigorously defend ourselves in this litigation.

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While management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse effect on our financial statements, the litigation and other claims noted above are subject to inherent uncertainties and management's view of these matters may change in the future. Adverse outcomes in some or all of the claims pending against us may result in significant monetary damages or injunctive relief against us that could adversely affect our ability to conduct our business. There also exists the possibility of a material adverse effect on our financial statements for the period in which the effect of an unfavorable final outcome becomes probable and reasonably estimable.

From time to time, we may become a party to other legal proceedings, including, without limitation, product liability claims, intellectual property claims, employment matters, commercial disputes, governmental inquiries and investigations (which may in some cases involve our entering into settlement arrangements or consent decrees), and other matters arising out of the ordinary course of our business. While the results of any legal proceeding cannot be predicted with certainty, in our opinion none of these other pending matters is anticipated to have a material adverse effect on our financial statements.

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

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

This Form 10-Q for the period ended January 26, 2019, contains certain forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are information of a non-historical nature and are subject to risks and uncertainties that are beyond Patterson's ability to control. Forward-looking statements generally can be identified by words such as "believes," "expects," "anticipates," "foresees," "forecasts," "estimates" or other words or phrases of similar import. It is uncertain whether any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do, what impact they will have on the results of operations and financial condition of Patterson or the price of Patterson stock. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those indicated in such forward-looking statements. Such risks and uncertainties include, without limitation, the cautionary language set forth herein; operations disruptions attributable to our enterprise resource planning system implementation; our ability to attract or retain qualified sales representatives and service technicians who relate directly with our customers; the reduction, modification, cancellation or delay of purchases of innovative, high-margin equipment; material changes in our purchasing relationships with suppliers; changes in general market and economic conditions; and the other risks and important factors contained and identified in Patterson's previous filings with the Securities and Exchange Commission, such as its Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K, any of which could cause actual results to differ materially from the forward-looking statements.

### OVERVIEW

Our financial information for the first nine months of fiscal 2019 is summarized in this Management's Discussion and Analysis and the Condensed Consolidated Financial Statements and related Notes. The following background is provided to readers to assist in the review of our financial information.

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

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

pharmaceutical products.

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We operate with a 52-53 week accounting convention with our fiscal year ending on the last Saturday in April. The third quarter of fiscal 2019 and 2018 represents the 13 weeks ended January 26, 2019 and the 13 weeks ended January 27, 2018, respectively. The nine months ended January 26, 2019 and January 27, 2018 each included 39 weeks. Fiscal 2019 will include 52 weeks and fiscal 2018 included 52 weeks.

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

**FACTORS AFFECTING OUR RESULTS**

**U.S. Tax Reform.** On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act ("Tax Act"). The Tax Act significantly revises the future ongoing U.S. federal corporate income tax by, among other things, lowering U.S. federal corporate tax rates and implementing a territorial tax system. Effective January 1, 2018, the Tax Act reduced the U.S. federal corporate tax rate from 35.0% to 21.0%.

**Receivables Securitization Program.** On July 24, 2018, we entered into a receivables purchase agreement with MUFG Bank, Ltd. ("MUFG"). Under this agreement, MUFG acts as an agent to facilitate the sale of certain Patterson receivables (the "Receivables") to certain unaffiliated financial institutions (the "Purchasers").

The proceeds from the sale of these Receivables comprise a combination of cash and a deferred purchase price ("DPP") receivable. The initial transaction was a sale of \$237.6 million of net receivables. From this sale, we received \$171.0 million of cash and a DPP receivable with a fair value of \$65.9 million. In addition, we recorded a loss of \$0.7 million as a result of this transaction. The proceeds from the initial sale were primarily used to reduce debt.

The DPP receivable is ultimately realized by Patterson following the collection of the underlying Receivables sold to the Purchasers. The collection of the DPP receivable is recognized as an increase to net cash provided by investing activities within the condensed consolidated statements of cash flows, with a corresponding reduction to net cash provided by operating activities within the condensed consolidated statements of cash flows.

**Legal Reserve.** In September 2018, we signed an agreement to settle the litigation entitled *In re Dental Supplies Antitrust Litigation*. Under the terms of the settlement, we paid \$28.3 million into escrow upon preliminary court approval. Such funds will be released upon final court approval of the settlement. We previously established a pre-tax reserve of \$28.3 million ("Legal Reserve") during the first quarter of fiscal 2019 to account for the settlement of this matter.

**RESULTS OF OPERATIONS**

**QUARTER ENDED JANUARY 26, 2019 COMPARED TO QUARTER ENDED JANUARY 27, 2018**

The following table summarizes our results as a percent of net sales:

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	Three Months Ended	
	January 26, 2019	January 27, 2018
Net sales	100.0 %	100.0 %
Cost of sales	78.6	78.6
Gross profit	21.4	21.4
Operating expenses	18.2	17.8
Operating income	3.2	3.6
Other income (expense)	(0.5 )	(0.7 )
Income before taxes	2.7	2.9
Income tax expense (benefit)	0.5	(5.0 )
Net income	2.2	7.9
Net loss attributable to noncontrolling interests	—	—
Net income attributable to Patterson Companies, Inc.	2.2 %	7.9 %

Net Sales. Consolidated net sales for the three months ended January 26, 2019 were \$1,396.7 million, an increase of 1.6% from \$1,375.2 million for the three months ended January 27, 2018. Foreign exchange rate changes had an unfavorable impact of 0.9% on current quarter sales.

Dental segment sales for the three months ended January 26, 2019 were \$579.7 million, an increase of 0.3% from \$577.9 million for the three months ended January 27, 2018. Foreign exchange rate changes had an unfavorable impact of 0.6% on current quarter sales. Current quarter sales of consumables decreased 2.5%, sales of dental equipment and software increased 5.1% to \$217.6 million, and sales of other dental services and products decreased 1.8%.

Animal Health segment sales for the three months ended January 26, 2019 were \$807.5 million, an increase of 1.6% from \$794.9 million for the three months ended January 27, 2018. Foreign exchange rate changes had an unfavorable impact of 1.1% on current quarter sales. Sales of certain products previously recognized on a gross basis were recognized on a net basis during the three months ended January 26, 2019, resulting in an estimated 0.1% unfavorable impact to sales. Positive end market fundamentals contributed to the current quarter sales growth.

Gross Profit. The consolidated gross profit margin rate for the three months ended January 26, 2019 was unchanged from the prior year quarter at 21.4%. Gross profit margin rates decreased in both the Dental and Animal Health segments during the three months ended January 26, 2019, while higher net sales in our Corporate segment related to customer financing contracts positively impacted the consolidated gross profit margin rate.

Operating Expenses. Consolidated operating expenses for the three months ended January 26, 2019 were \$254.1 million, a 3.9% increase from the prior year quarter of \$244.7 million. We incurred higher operating expenses during the three months ended January 26, 2019 primarily as a result of higher personnel costs. The consolidated operating expense ratio of 18.2% increased 40 basis points from the prior year quarter, which was also driven by this same factor.

Operating Income. For the three months ended January 26, 2019, operating income was \$45.4 million, or 3.2% of net sales, as compared to \$50.0 million, or 3.6% of net sales for the three months ended January 27, 2018. The decrease in operating income was primarily due to higher operating expenses, partially offset by higher gross margins. The decrease in operating income as a percent of sales was primarily due to higher operating expenses.

Dental segment operating income was \$51.1 million for the three months ended January 26, 2019, a decrease of \$7.3 million from the prior year quarter. The decrease in operating income was primarily due to higher operating expenses, including higher personnel costs, as well as lower gross margins.

Animal Health segment operating income was \$15.0 million for the three months ended January 26, 2019, a decrease of \$3.0 million from the prior year quarter. The decrease in operating income was primarily due to greater operating expenses incurred during the three months ended January 26, 2019, including higher personnel costs.





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Corporate segment operating loss was \$20.8 million for the three months ended January 26, 2019, as compared to a loss of \$26.4 million for the three months ended January 27, 2018. The change was driven primarily by higher net sales related to our customer financing contracts during the three months ended January 26, 2019, partially offset by higher professional services expenses.

Other Income (Expense). Net other expense for the three months ended January 26, 2019 was \$7.7 million, compared to \$9.7 million for the three months ended January 27, 2018. Net other expense was lower during the three months ended January 26, 2019 primarily due to lower interest expense, which was primarily driven by the retirement of long-term debt during the three months ended January 26, 2019.

Income Tax Expense (Benefit). The effective income tax rate for the three months ended January 26, 2019 was 17.4% compared to (170.0)% for the three months ended January 27, 2018. The change in the tax rate was primarily due to the impact of the Tax Act.

Net Income Attributable to Patterson Companies Inc. and Earnings Per Share. Net income attributable to Patterson Companies Inc. for the three months ended January 26, 2019 was \$31.2 million, compared to \$109.0 million for the three months ended January 27, 2018. Earnings per diluted share were \$0.33 in the current quarter compared to \$1.18 in the prior year quarter. Weighted average diluted shares outstanding in the current quarter were 93.7 million, compared to 92.6 million in the prior year quarter. The current quarter and prior year quarter cash dividend was \$0.26 per common share.

**NINE MONTHS ENDED JANUARY 26, 2019 COMPARED TO NINE MONTHS ENDED JANUARY 27, 2018**

The following table summarizes our results as a percent of net sales:

	Nine Months Ended	
	January 26, 2019	January 27, 2018
Net sales	100.0 %	100.0 %
Cost of sales	78.8	77.6
Gross profit	21.2	22.4
Operating expenses	19.0	18.0
Operating income	2.2	4.4
Other income (expense)	(0.5 )	(0.7 )
Income before taxes	1.7	3.7
Income tax expense (benefit)	0.4	(0.7 )
Net income	1.3	4.4
Net loss attributable to noncontrolling interests	—	—
Net income attributable to Patterson Companies, Inc.	1.3 %	4.4 %

Net Sales. Consolidated net sales for the nine months ended January 26, 2019 were \$4,137.8 million, a 1.8% increase from \$4,065.1 million for the nine months ended January 27, 2018. Foreign exchange rate changes had an unfavorable impact of 0.2% on current period sales.

Dental segment sales for the nine months ended January 26, 2019 were \$1,628.3 million, a 1.3% decrease from \$1,650.3 million for the nine months ended January 27, 2018. Foreign exchange rate changes had an unfavorable impact of 0.2% on current period sales. Current period sales of consumables decreased 3.3%, sales of dental equipment and software increased 3.2% to \$520.3 million, and sales of other dental services and products decreased 3.3% for the nine months ended January 26, 2019. The decrease in sales of consumables was mainly due to changes in our sales force and disruptions resulting from our ERP system initiatives.

Animal Health segment sales for the nine months ended January 26, 2019 were \$2,488.1 million, a 3.9% increase from \$2,394.6 million for the nine months ended January 27, 2018. Foreign exchange rate changes had an unfavorable impact of 0.3% on current period sales. Sales of certain products previously recognized on a gross basis were recognized



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on a net basis during the nine months ended January 26, 2019, resulting in an estimated 0.2% unfavorable impact to sales. Positive end market fundamentals contributed to the current period sales growth.

**Gross Profit.** The consolidated gross profit margin rate for the nine months ended January 26, 2019 decreased 120 basis points from the prior year period to 21.2%. Gross profit margin rates decreased in both the Dental and Animal Health segment. A greater percentage of sales came from our lower margin Animal Health segment during the nine months ended January 26, 2019, resulting in a lower consolidated gross profit margin rate. Unfavorable sales mix, pricing pressure at the point of sale and inventory adjustments in both our Dental and Animal Health segment also contributed to the decline in the consolidated gross profit margin rate.

**Operating Expenses.** Consolidated operating expenses for the nine months ended January 26, 2019 were \$787.2 million, a 7.7% increase from the prior year period of \$730.9 million. We incurred higher operating expenses during the nine months ended January 26, 2019 primarily as a result of the \$28.3 million Legal Reserve, higher personnel costs and higher professional services expenses. The consolidated operating expense ratio of 19.0% increased 100 basis points from the prior year period, which was also driven by these same factors.

**Operating Income.** For the nine months ended January 26, 2019, operating income was \$91.1 million, or 2.2% of net sales, as compared to \$178.6 million, or 4.4% of net sales for the nine months ended January 27, 2018. The decrease in operating income and operating income as a percent of sales was primarily due to a decrease in operating margins in our Dental segment, the impact of the \$28.3 million Legal Reserve and higher professional services expenses. In addition, a greater percentage of sales came from our lower margin Animal Health segment during the nine months ended January 26, 2019, which lowered operating income as a percent of sales.

Dental segment operating income was \$128.6 million for the nine months ended January 26, 2019, a decrease of \$54.6 million from the prior year period. The decrease in operating income was primarily due to lower net sales and a lower gross profit margin rate in the current period, in addition to greater operating expenses.

Animal Health segment operating income was \$56.1 million for the nine months ended January 26, 2019, a decrease of \$1.8 million from the prior year period. The decrease in operating income was primarily due to higher operating expenses, partially offset by higher gross margins.

Corporate segment operating loss was \$93.6 million for the nine months ended January 26, 2019, as compared to a loss of \$62.5 million for the nine months ended January 27, 2018. The change was driven primarily by the \$28.3 million Legal Reserve established during the first quarter of fiscal 2019, as well as higher professional services expenses.

**Other Income (Expense).** Net other expense was \$21.2 million for the nine months ended January 26, 2019, compared to \$29.7 million for the nine months ended January 27, 2018. Net other expense was lower during the nine months ended January 26, 2019 due to lower interest expense, which was primarily driven by the retirement of \$244.0 million of long-term debt during the nine months ended January 26, 2019, and the recognition of a gain related to an investment.

**Income Tax Expense (Benefit).** The effective income tax rate for the nine months ended January 26, 2019 was 21.0% compared to (20.9)% for the nine months ended January 27, 2018. The change in the tax rate was primarily due to the impact of the Tax Act.

**Net Income Attributable to Patterson Companies Inc. and Earnings Per Share.** Net income attributable to Patterson Companies Inc. for the nine months ended January 26, 2019 was \$55.6 million, compared to \$180.0 million for the nine months ended January 27, 2018. Earnings per diluted share were \$0.60 in the current period compared to \$1.93 in the prior year period. Weighted average diluted shares outstanding in both the current period and prior year period were 93.3 million. The current period and prior year period cash dividend was \$0.78 per common share.

**LIQUIDITY AND CAPITAL RESOURCES**

For the nine months ended January 26, 2019, net cash provided by operating activities was \$76.3 million, compared to net cash provided by operating activities of \$40.0 million for the nine months ended January 27, 2018. The net cash provided by operating activities during the nine months ended January 26, 2019 was primarily driven by a reduction in working capital, partially offset by the impact of our Receivables Securitization Program.



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For the nine months ended January 26, 2019, net cash provided by investing activities was \$277.5 million, compared to net cash provided by investing activities of \$19.4 million for the nine months ended January 27, 2018. Net cash flows for the nine months ended January 26, 2019 were positive primarily due to the collection of \$308.6 million of DPP receivables. We expect to use a total of approximately \$60 million for capital expenditures in fiscal 2019.

Net cash used in financing activities for the nine months ended January 26, 2019 was \$299.5 million. Uses of cash consisted primarily of \$244.0 million for the retirement of long-term debt and \$74.7 million for dividend payments.

For the nine months ended January 27, 2018, net cash used in financing activities was \$42.0 million. Uses of cash consisted primarily of \$87.5 million for share repurchases and \$74.6 million for dividend payments. Cash proceeds included \$120.0 million attributed to draws on our revolving line of credit.

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

As of January 26, 2019, \$92.6 million of the Amended Credit Agreement unsecured term loan was outstanding at an interest rate of 4.0%, and \$29.0 million was outstanding under the Amended Credit Agreement revolving line of credit at an interest rate of 3.9%. At April 28, 2018, \$276.6 million was outstanding under the Amended Credit Agreement unsecured term loan at an interest rate of 3.4%, and \$16.0 million was outstanding under the Amended Credit Agreement revolving line of credit at an interest rate of 2.9%.

We expect funds generated from operations, existing cash balances and credit availability under existing debt facilities will be sufficient to meet our working capital needs and to finance strategic initiatives over the remainder of fiscal 2019.

**RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

See Note 1 to the Condensed Consolidated Financial Statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in our exposure to market risk from that disclosed in Item 7A in our 2018 Annual Report on Form 10-K filed June 27, 2018.

**ITEM 4. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our management, including our President and Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"), management evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of January 26, 2019. Based upon their evaluation of these disclosure controls and procedures, the CEO and CFO concluded that the disclosure controls and procedures were effective as of January 26, 2019.

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended January 26, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## PART II—OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

In September 2015, we were served with a summons and complaint in an action commenced in the U.S. District Court for the Eastern District of New York, entitled SourceOne Dental, Inc. v. Patterson Companies, Inc., Henry Schein, Inc. and Benco Dental Supply Company, Civil Action No. 15-cv-05440-JMA-GRB. SourceOne, as plaintiff, alleges that, through its website, it markets and sells dental supplies and equipment to dentists. SourceOne alleges in the complaint, among other things, that we, along with the defendants Henry Schein and Benco, conspired to eliminate plaintiff as a competitor and to exclude them from the market for the marketing, distribution and sale of dental supplies and equipment in the U.S. and that defendants unlawfully agreed with one another to boycott dentists, manufacturers, and state dental associations that deal with, or considered dealing with, plaintiff. Plaintiff asserts the following claims: (i) unreasonable restraint of trade in violation of state and federal antitrust laws; (ii) tortious interference with prospective business relations; (iii) civil conspiracy; and (iv) aiding and abetting the other defendants' ongoing tortious and anticompetitive conduct. Plaintiff seeks equitable relief, compensatory and treble damages, jointly and severally, punitive damages, interest, and reasonable costs and expenses, including attorneys' fees and expert fees. In June 2017, Henry Schein settled with SourceOne and was dismissed from this litigation with prejudice. We are vigorously defending ourselves in this litigation. Trial is scheduled to begin on April 29, 2019. We do not anticipate that this matter will have a material adverse effect on our financial statements.

Beginning in January 2016, purported antitrust class action complaints were filed against defendants Henry Schein, Inc., Benco Dental Supply Company and Patterson Companies, Inc. Although there were factual and legal variations among these complaints, each alleged that defendants conspired to foreclose and exclude competitors by boycotting manufacturers, state dental associations, and others that deal with defendants' competitors. On February 9, 2016, the U.S. District Court for the Eastern District of New York ordered all of these actions, and all other actions filed thereafter asserting substantially similar claims against defendants, consolidated for pre-trial purposes. On February 26, 2016, a consolidated class action complaint was filed by Arnell Prato, D.D.S., P.L.L.C., d/b/a Down to Earth Dental, Evolution Dental Sciences, LLC, Howard M. May, DDS, P.C., Casey Nelson, D.D.S., Jim Peck, D.D.S., Bernard W. Kurek, D.M.D., Larchmont Dental Associates, P.C., and Keith Schwartz, D.M.D., P.A. (collectively, "putative class representatives") in the U.S. District Court for the Eastern District of New York, entitled In re Dental Supplies Antitrust Litigation, Civil Action No. 1:16-CV-00696-BMC-GRB. Subject to certain exclusions, the putative class representatives seek to represent all private dental practices and laboratories who purchased dental supplies or equipment in the U.S. directly from any of the defendants, during the period beginning August 31, 2008 until March 31, 2016. In the consolidated class action complaint, putative class representatives allege a nationwide agreement among Henry Schein, Benco, Patterson and non-party Burkhart Dental Supply Company, Inc. not to compete on price. The consolidated class action complaint asserts a single count under Section 1 of the Sherman Act, and seeks equitable relief, compensatory and treble damages, jointly and severally, interest, and reasonable costs and expenses, including attorneys' fees and expert fees. On September 28, 2018, the parties executed a settlement agreement that proposes, subject to court approval, a full and final settlement of the lawsuit on a class-wide basis. Subject to certain exceptions, the settlement class consists of all persons or entities that purchased dental products directly from Henry Schein, Patterson, Benco and Burkhart, or any combination thereof, during the period August 31, 2008 through and including March 31, 2016. As a result, we recorded a charge of \$28.3 million in our first quarter 2019 results in our Corporate segment.

On August 31, 2012, Archer and White Sales, Inc. ("Archer") filed a complaint against Henry Schein, Inc. as well as Danaher Corporation and its subsidiaries Instrumentarium Dental, Inc., Dental Equipment, LLC, Kavos Dental Technologies, LLC and Dental Imaging Technologies Corporation (collectively, the "Danaher Defendants") in the United States District Court for the Eastern District of Texas, Civil Action No. 2:12-CV-00572-JRG, styled as an antitrust action under Section 1 of the Sherman Act, and the Texas Free Enterprise Antitrust Act. Archer alleges a conspiracy between Henry Schein, an unnamed company and the Danaher Defendants to terminate or limit Archer's distribution rights. On August 1, 2017, Archer filed an amended complaint, adding Patterson Companies, Inc. and

Benco Dental Supply Company as defendants, and alleging that Henry Schein, Patterson, Benco and non-defendant Burkhart Dental Supply Company, Inc. conspired to pressure and agreed to enlist their common suppliers, including the Danaher Defendants, to join a price-fixing conspiracy and boycott by reducing the distribution territory of, and eventually terminating, Archer. Archer seeks injunctive relief, and damages in an amount to be proved at trial, to be trebled with interest and costs, including attorneys' fees, jointly and severally. On June 25, 2018, the United States Supreme Court granted certiorari to review an arbitration issue raised by the Danaher Defendants, thereby continuing the case stay implemented in March 2018. On October 29, 2018, the Supreme Court heard oral arguments. On January 8, 2019, the Supreme Court issued its published decision vacating the judgment of the U.S. Court of Appeals for the Fifth Circuit and remanding the case to the Fifth Circuit for further proceedings on a second arbitration issue consistent with the Supreme Court's

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opinion. We are vigorously defending ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial statements.

On August 17, 2017, IQ Dental Supply, Inc. (“IQ Dental”) filed a complaint in the United States District Court for the Eastern District of New York, entitled IQ Dental Supply, Inc. v. Henry Schein, Inc., Patterson Companies, Inc. and Benco Dental Supply Company, Case No. 2:17-cv-4834. Plaintiff alleges that it is a distributor of dental supplies and equipment, and sells dental products through an online dental distribution platform operated by SourceOne Dental, Inc. IQ Dental alleges, among other things, that defendants conspired to suppress competition from IQ Dental and SourceOne for the marketing, distribution and sale of dental supplies and equipment in the United States, and that defendants unlawfully agreed with one another to boycott dentists, manufacturers and state dental associations that deal with, or considered dealing with, plaintiff and SourceOne. Plaintiff claims that this alleged conduct constitutes unreasonable restraint of trade in violation of Section 1 of the Sherman Act, New York’s Donnelly Act and the New Jersey Antitrust Act, and also makes pendant state law claims for tortious interference with prospective business relations, civil conspiracy and aiding and abetting. Plaintiff seeks injunctive relief, compensatory, treble and punitive damages, jointly and severally, and reasonable costs and expenses, including attorneys’ fees and expert fees. On December 21, 2017, the District Court granted defendants motion to dismiss the complaint with prejudice. Plaintiff has appealed the District Court’s order. The U.S. Court of Appeals for the Second Circuit heard oral argument on the appeal on September 13, 2018. The court’s decision is pending. We are vigorously defending ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial statements.

On February 12, 2018, the Federal Trade Commission (“FTC”) issued an administrative complaint entitled In the Matter of Benco Dental Supply Co., Henry Schein, Inc., and Patterson Companies, Inc. Docket No. 9379. The administrative complaint alleges “reason to believe” that Patterson and the other respondents violated Section 5 of the FTC Act, 15 U.S.C. § 45 by conspiring to refuse to offer discounted prices or otherwise negotiate with buying groups seeking to obtain supply agreements on behalf of groups of solo practitioners or small group dental practices. The administrative complaint seeks injunctive relief against Patterson, including an order to cease and desist from the conduct alleged in the complaint and a prohibition from conspiring or agreeing with any competitor or any person to refuse to provide discounts to or compete for the business of any customer. No money damages are sought. We are vigorously defending ourselves against the administrative complaint. The hearing in front of an Administrative Law Judge of the FTC in Washington, D.C. began on October 16, 2018. The factual record closed on February 21, 2019 and the parties are in the process of post-trial briefing before the Administration Law Judge. We do not anticipate this matter will have a material adverse effect on our financial statements.

On March 28, 2018, Plymouth County Retirement System (“Plymouth”) filed a federal securities class action complaint against Patterson Companies, Inc. and its former CEO Scott P. Anderson and former CFO Ann B. Gugino in the U.S. District Court for the District of Minnesota in a case captioned Plymouth County Retirement System v. Patterson Companies, Inc., Scott P. Anderson and Ann B. Gugino, Case No. 0:18-cv-00871 MJD/SER. On November 9, 2018, the complaint was amended to add former CEO James W. Wiltz and former CFO R. Stephen Armstrong as individual defendants. Under the amended complaint, on behalf of all persons or entities that purchased or otherwise acquired Patterson’s common stock between June 26, 2013 and February 28, 2018, Plymouth alleges that Patterson violated federal securities laws by failing to disclose that Patterson’s revenue and earnings were “artificially inflated by Defendants’ illicit, anti-competitive scheme with its purported competitors, Benco and Schein, to prevent the formation of buying groups that would allow its customers who were office-based practitioners to take advantage of pricing arrangements identical or comparable to those enjoyed by large-group customers.” In its class action complaint, Plymouth asserts one count against Patterson for violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and a second, related count against the individual defendants for violating Section 20(a) of the Exchange Act. Plymouth seeks compensatory damages, pre- and post-judgment interest and reasonable attorneys’ fees and experts’ witness fees and costs. On August 30, 2018, Gwinnett County Public Employees Retirement System and Plymouth County Retirement System, Pembroke Pines Pension Fund for Firefighters and



Police Officers, Central Laborers Pension Fund were appointed lead plaintiffs. While the outcome of litigation is inherently uncertain, we believe that the class action complaint is without merit, and we are vigorously defending ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial statements. Patterson has also received requests under Minnesota Business Corporation Act § 302A.461 to inspect corporate books and records relating to the issues raised in the securities class action and the antitrust matters discussed above.

During the first quarter of fiscal 2019, the U.S. Attorney's Office for the Western District of Virginia informed us that our subsidiary, Animal Health International, Inc., has been designated a target of a criminal investigation. The investigation relates to Animal Health International sales of prescription animal health products to certain persons and/

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or locations not licensed to receive them in Virginia and Tennessee in violation of federal and state laws. In October 2018, we entered into a three-month tolling agreement, which was subsequently extended to July 31, 2019, to allow us to produce documents responsive to grand jury subpoenas and to allow for further evaluation of evidence. In December 2018, as a result of our ongoing internal investigation, we advised the U.S. Attorney's Office of our shipments of prescription animal health products that were made from a warehouse rather than a pharmacy in the states of Virginia and Tennessee. We have modified our shipment processes and are continuing to evaluate the need for further modification. We continue to cooperate with the U.S. Attorney's Office on this matter. At this time, we are unable to make an estimate of the amount of loss, if any, or range of possible loss that we could incur as a result of the foregoing matter.

On August 28, 2018, Kirsten Johnsen filed a stockholder derivative complaint against Patterson Companies, Inc., as a nominal defendant, and the following former and current officers and directors of Patterson: Scott Anderson, Ann Gugino, James Wiltz, John Buck, Jody Feragen, Ellen Rudnick, Les Vinney, Neil Schrimsher, Sarena Lin, Harold Slavkin, Alex Blanco and Mark Walchirk as individual defendants in Hennepin County District Court in a case captioned Kirsten Johnsen v. Scott P. Anderson et al., Case No. 27-CV-18-14315. Derivatively on behalf of Patterson, plaintiff alleges that Patterson "suppressed price competition and maintained supracompetitive prices for dental supplies and equipment by entering into agreements with Henry Schein and Benco to: (i) fix margins for dental supplies and equipment; and (ii) block the entry and expansion of lower-margin, lower-priced, rival dental distributors through threatened and actual group boycotts." Plaintiff further alleges that the individual defendants failed to disclose Patterson's alleged "price-fixing scheme" to the public and purportedly "caused Patterson to repurchase over \$412.8 million worth of its own stock at artificially inflated prices." In the derivative complaint, plaintiff asserts three counts against the individual defendants for: (i) breach of fiduciary duty; (ii) waste of corporate assets; and (iii) unjust enrichment. Plaintiff seeks compensatory damages, equitable and injunctive relief as permitted by law, costs, disbursements and reasonable attorneys' fees, accountants' fees and experts' fees, costs and expenses, and an order awarding restitution from the individual defendants and directing Patterson "to take all necessary actions to reform and improve its corporate governance and internal procedures." On February 19, 2019, the court ordered this litigation stayed pending resolution of the below-described case brought by Sally Pemberton. While the outcome of litigation is inherently uncertain, we believe that the derivative complaint is without merit, and we intend to vigorously defend ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial statements.

On October 1, 2018, Sally Pemberton filed a stockholder derivative complaint against Patterson Companies, Inc., as a nominal defendant, and the following former and current officers and directors of Patterson: Scott Anderson, Ann Gugino, Mark Walchirk, John Buck, Alex Blanco, Jody Feragen, Sarena Lin, Ellen Rudnick, Neil Schrimsher, Les Vinney, James Wiltz, Paul Guggenheim, David Misiak and Tim Rogan as individual defendants in the United States District Court for the District of Minnesota in a case captioned Sally Pemberton v. Scott P. Anderson, et al., Case No. 18-CV-2818. Derivatively on behalf of Patterson, plaintiff alleges that Patterson, with Benco and Henry Schein, "engage[d] in a conspiracy in restraint of trade, whereby the companies agreed to refuse to offer discounted prices or otherwise negotiate with GPOs, agreed to fix margins on dental supplies and equipment, agreed not to poach one another's customers or sales representatives, and agreed to block the entry and expansion of rival distributors. Plaintiff further alleges that the individual defendants failed to disclose Patterson's alleged "antitrust misconduct" to the public and purportedly caused Patterson to repurchase \$412.8 million of its own stock at prices that were artificially inflated. In the derivative complaint, plaintiff asserts six counts against the individual defendants for: (i) breach of fiduciary duty; (ii) waste of corporate assets; (iii) unjust enrichment; (iv) violations of Section 14(a) of the Exchange Act; (v) violations of Section 10(b) and Rule 10b-5 of the Exchange Act and (vi) violations of Section 20(a) of the Exchange Act. Plaintiff seeks compensatory damages with pre-judgment and post-judgment interest, costs, disbursements and reasonable attorneys' fees, experts' fees, costs and expenses, and an order awarding restitution from the individual defendants and directing Patterson "to take all necessary actions to reform and improve its corporate governance and internal procedures." While the outcome of litigation is inherently uncertain, we believe that the derivative complaint is

without merit, and we intend to vigorously defend ourselves in this litigation. We do not anticipate that this matter will have a material adverse effect on our financial statements.

On October 9, 2018, Nathaniel Kramer filed indirect purchaser litigation against Patterson Companies, Inc., Henry Schein, Inc. and Benco Dental Supply Company in the United States District Court for the District of Northern District of California. The purported class action complaint asserts violations of the California Cartwright Act and the California Unfair Competition Act based on an alleged agreement between Schein, Benco, and Patterson (and unnamed co-conspirators) not to compete as to price and margins. Plaintiff alleges that the agreement allowed the defendants to charge higher prices to dental practices for dental supplies and that the dental practices passed on all, or part of, the increased prices to the consumers of dental services. Subject to certain exclusions, the complaint defines the class

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as all persons residing in California purchasing and/or reimbursing for dental services from California dental practices. The complaint seeks a permanent injunction, actual damages to be determined at trial, trebled, reasonable attorneys' fees and costs, and pre- and post-judgment interest. On December 7, 2018, an amended complaint was filed asserting the same claims against the same parties. While the outcome of litigation is inherently uncertain, we believe that the indirect purchaser action is without merit, and we intend to vigorously defend ourselves in this litigation.

On January 29, 2019, a purported class action complaint was filed by R. Lawrence Hatchett, M.D. against Patterson Companies, Inc., Henry Schein, Inc., Benco Dental Supply Company, and unnamed co-conspirators in the U.S. District Court for the Southern District of Illinois. The complaint alleges that members of the proposed class suffered antitrust injury due to an unlawful boycott, price-fixing or otherwise anticompetitive conspiracy among Schein, Benco and Patterson. The complaint alleges that the alleged conspiracy overcharged Illinois dental practices, orthodontic practices and dental laboratories on their purchase of dental supplies, which in turn passed on some or all of such overcharges to members of the class. Subject to certain exclusions, the complaint defines the class as all persons residing in Illinois purchasing and/or reimbursing for dental care provided by independent Illinois dental practices purchasing dental supplies from the defendants, or purchasing from buying groups purchasing these supplies from the defendants, on or after January 29, 2015. The complaint alleges violations of the Illinois Antitrust Act, 740 Ill. Comp. Stat. §§ 10/3(2), 10/7(2), and seeks a permanent injunction, actual damages to be determined at trial, trebled, reasonable attorneys' fees and costs, and pre- and post-judgment interest. While the outcome of litigation is inherently uncertain, we believe that the indirect purchaser action is without merit, and we intend to vigorously defend ourselves in this litigation.

While management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse effect on our financial statements, the litigation and other claims noted above are subject to inherent uncertainties and management's view of these matters may change in the future. Adverse outcomes in some or all of the claims pending against us may result in significant monetary damages or injunctive relief against us that could adversely affect our ability to conduct our business. There also exists the possibility of a material adverse effect on our financial statements for the period in which the effect of an unfavorable final outcome becomes probable and reasonably estimable.

From time to time, we may become a party to other legal proceedings, including, without limitation, product liability claims, intellectual property claims, employment matters, commercial disputes, governmental inquiries and investigations (which may in some cases involve our entering into settlement arrangements or consent decrees), and other matters arising out of the ordinary course of our business. While the results of any legal proceeding cannot be predicted with certainty, in our opinion none of these other pending matters is anticipated to have a material adverse effect on our financial statements.

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

### Purchases of Equity Securities by the Issuer

On March 13, 2018, the Board of Directors authorized a new \$500 million share repurchase program through March 13, 2021. The new repurchase program replaced the remaining authorization from our previous plan to purchase up to 25 million shares, which was scheduled to expire on March 19, 2018.

No shares were repurchased under the stock repurchase plan during the third quarter of fiscal 2019.

In fiscal 2017, we entered into an amended credit agreement ("Amended Credit Agreement"), consisting of a \$295.1 million term loan and a \$750 million revolving line of credit. The Amended Credit Agreement permits us to declare and pay dividends, and repurchase shares, provided that no default or unmatured default exists and that we are in compliance with applicable financial covenants.

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ITEM 6. EXHIBITS

Exhibit No. Exhibit Description

- 10.1 Note Purchase Agreement, dated December 8, 2011, by and among Patterson Companies, Inc., Patterson Medical Holdings, Inc., Patterson Medical Supply, Inc., Patterson Dental Holdings, Inc., Patterson Dental Supply, Inc., Webster Veterinary Supply, Inc., Webster Management, LP, conformed through Second Amendment, dated January 25, 2019.
- 10.2 First Amendment, dated as of January 25, 2019, to the Note Purchase Agreement, dated March 23, 2015, by and among Patterson Companies, Inc., Patterson Dental Holdings, Inc., Patterson Dental Supply, Inc., Patterson Veterinary Supply, Inc., and Patterson Management, LP.
- 10.3 First Amendment, dated as of January 25, 2019, to the Note Purchase Agreement, dated as of March 29, 2018, by and among Patterson Companies, Inc., Patterson Dental Holdings, Inc., Patterson Dental Supply, Inc., Patterson Veterinary Supply, Inc., and Patterson Management, LP.
- 10.4 Eleventh Amendment to Amended and Restated Contract Purchase Agreement, dated as of December 14, 2018, by and among PDC Funding Company II, LLC, as seller, Patterson Companies, Inc., as servicer, the purchasers party thereto, and Fifth Third Bank, as agent.
- 10.5 Amendment No 14 to Third Amended and Restated Receivables Purchase Agreement, dated as of October 9, 2018, by and among PDC Funding Company, LLC, as seller, Patterson Companies, Inc., as servicer, the conduits party thereto, the financial institutions party thereto, the purchaser agents party thereto, and MUFG Bank, Ltd. (f.k.a. The Bank of Tokyo-Mitsubishi UFJ, Ltd.), as agent.
- 10.6 Receivables Sale Agreement, dated as of May 10, 2002, by and among Patterson Dental Supply, Inc., Webster Veterinary Supply, Inc., and PDC Funding Company, LLC, conformed through Amendment No. 4, dated as of October 9, 2018.
- 10.7 Amended and Restated Credit Agreement dated as of January 27, 2017, by and among Patterson Companies, Inc., the lenders from time to time parties thereto, Bank of Tokyo-Mitsubishi UFJ, Ltd., as administrative agent, and Bank of America, N.A., as syndication agent, conformed through Amendment No. 2, dated as of November 30, 2018.
- 31.1 Certification of the Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Financials in XBRL format.

All other items under Part II have been omitted because they are inapplicable or the answers are negative, or were previously reported in the 2018 Annual Report on Form 10-K filed June 27, 2018.

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SIGNATURES

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

PATTERSON COMPANIES, INC.  
(Registrant)

Dated: March 6, 2019 By: /s/ Donald J. Zurbay  
Donald J. Zurbay  
Chief Financial Officer and Treasurer  
(Principal Financial Officer and Principal Accounting Officer)