



Patterson Companies, Inc. (PDCO)

Updated September 8th, 2024 by Prakash Kolli

Key Metrics

Current Price:	\$21	5 Year CAGR Estimate:	13.7%	Market Cap:	\$1.82B
Fair Value Price:	\$31	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	10/19/24
% Fair Value:	67%	5 Year Valuation Multiple Estimate:	8.4%	Dividend Payment Date:	10/20/24
Dividend Yield:	5.0%	5 Year Price Target	\$34	Years Of Dividend Growth:	0
Dividend Risk Score:	B	Retirement Suitability Score:	A	Rating:	Buy

Overview & Current Events

Patterson Companies, Inc. traces its history back to 1877 in the dental market. The company entered the animal health market with the 2001 purchase of Webster Veterinary. Patterson acquired Animal Health International, Inc. in 2015 and Miller Vet Holdings in 2021. Today the company is a large Dental and Animal Health distributor and wholesaler selling dental and animal health products, equipment, devices, office management products, and services. The Dental segment operates in the US and Canada, while the Animal Health segment operates in North America and the UK. In FY 2024, total sales were \$6.5B with ~62% coming from Animal Health and ~38% from Dental.

Patterson reported Q1 FY 2025 on August 28th, 2024. For the quarter, revenue declined 2.2% to \$1,542M from \$1,578M while diluted GAAP earnings per share declined to \$0.15 from \$0.32 on a year-over-year basis. On an adjusted basis, earnings per share decreased to \$0.24 from \$0.40. Of note, gross profit margins fell -50 bps to 20.1% and operating margins decreased 110 bps to 2.3%. The Animal Health segment sales decreased 2.8% to \$982M from \$1,011M in comparable periods because of falling consumable and equipment sales, offset by services. The Dental Health segment sales decreased 3.0% to \$550M from \$567M in the prior year, driven by falling consumables, equipment, and services sales. The cybersecurity attack on Change Healthcare affected dental sales.

Patterson is being affected by higher inflation and interest rates. However, the company has raised prices, managed costs, and introduced new products to counter negative trends.

Patterson maintained guidance for adjusted earnings per share of \$2.33 to \$2.43 in fiscal 2025.

Growth on a Per-Share Basis

Year ¹	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
EPS	\$2.24	\$1.90	\$1.82	\$2.16	\$1.40	\$1.55	\$1.91	\$2.27	\$2.42	\$2.30	\$2.38	\$2.63
DPS	\$0.82	\$0.86	\$0.94	\$1.02	\$1.04	\$1.04	\$1.04	\$1.04	\$1.04	\$1.04	\$1.04	\$1.04
Shares²	99.1	96.5	94.8	95.3	96.0	96.8	96.8	96.9	95.3	87.8	87.3	85.2

Patterson grew earnings per share until 2015 when it completed the Animal Health International acquisition. Poor execution and lower margins adversely impacted the company. Patterson navigated through the COVID-19 pandemic reasonably well. Adjusted earnings increased for FY 2020 and FY 2021 despite headwinds from COVID-19. The Dental segment and Animal Healthcare segment to a lesser degree were disrupted from mid-March until early-June in 2020. However, revenue growth is now flat and earnings per share declined after peaking in 2023.

We now believe that diluted earnings per share will increase on average about 2.0% annually out to FY 2030. We now forecast on average a 0.5% annual reduction in share count. The company consistently raised the dividend in the past, but there has been no increase since fiscal year 2019. We are not forecasting any dividend increases over the next few years. The payout ratio has come down but raising the dividend is not an indicated priority. Patterson is seemingly focused on share buybacks.

¹ Patterson's fiscal year ends the last Saturday in April. The values in the tables are in fiscal year.

² Share count in millions.

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Valuation Analysis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Now	2030
Avg. P/E	24.2	24.7	17.0	25.7	25.7	16.9	16.8	12.8	11.7	10.6	8.7	13.0
Avg. Yld.	1.9%	2.1%	2.8%	4.5%	5.2%	3.8%	3.3%	3.6%	3.7%	4.3%	5.0%	3.0%

Patterson’s stock price is down again since our last report on missing estimates. We kept our forecast at the mid-point of FY 2025 guidance. We again lowered our fair value multiple to 13X, below the 5-year average, accounting for past merger integration difficulties and poor operational execution. Our fair value stock price is now \$31. Our 5-year price target is now \$34.

Safety, Quality, Competitive Advantage, & Recession Resiliency

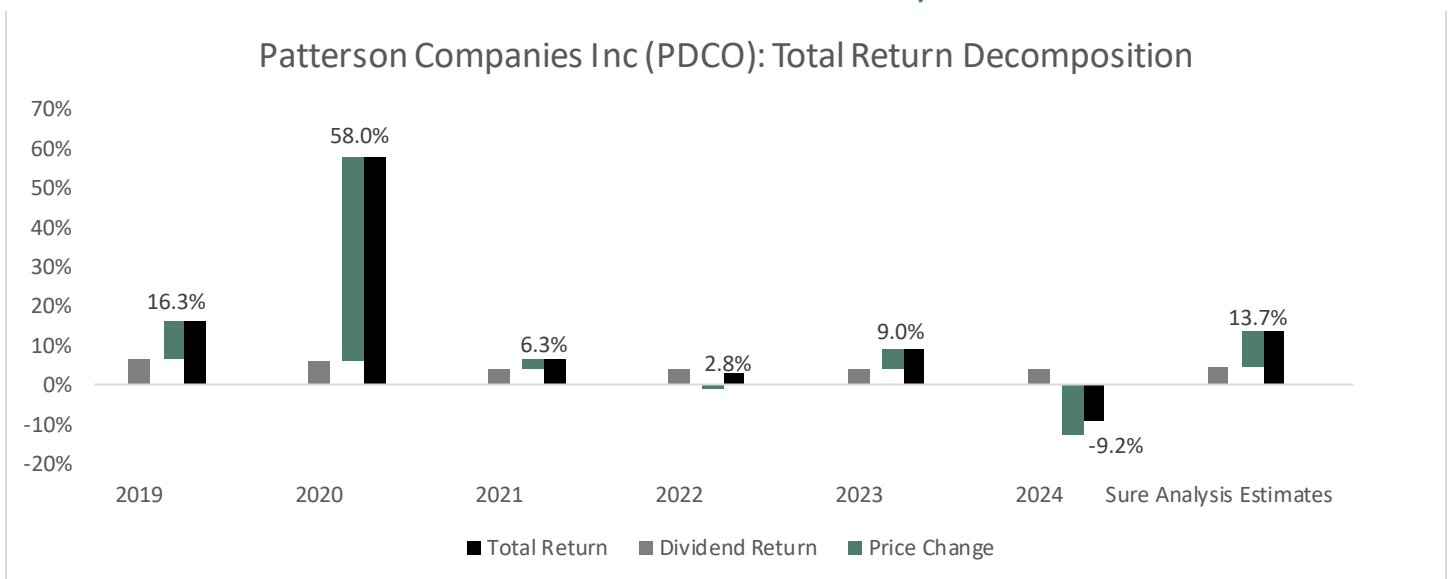
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
Payout	37%	45%	52%	47%	74%	67%	54%	46%	43%	45%	44%	40%

Patterson Companies is a major dental supply provider along with Henry Schein and Benco, who together control about 85% of the market. Patterson has about 30% of the market and this scale should theoretically provide a competitive advantage. But with strong competitors, several regional competitors, and online competitors for consumables there is little pricing power. The animal health market has also proven difficult in the past with little in the way of organic growth. Henry Schein acknowledged the challenges in this market by conducting an IPO for its animal health division. Furthermore, there is likely little revenue and cost synergies between the dental health and animal health businesses. Patterson had a decent amount of debt for a company of its size but has deleveraged. At end of Q1 FY2025, the company had \$123.9M in short-term or current long-term debt and \$327.2M in long-term debt. This is offset by \$148.1M in cash and cash equivalents. Interest coverage is now ~5.5X and leverage ratio is about 2.0X.

Final Thoughts & Recommendation

At present we are forecasting on average 13.7% total annualized return over the next five years from a dividend yield of 5.0%, 2.0% EPS growth, and 8.4% P/E multiple expansion. Patterson’s fiscal year 2024 was challenging because of a difficult animal health market, inflation, and high interest rates. It looks like FY 2025 may have similar trends. That said, income investors may like the combination of dividend yield and safety. We have maintained our buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Revenue	3911	5387	5593	5466	5575	5490	5912	6499	6471	6568
Gross Profit	1061	1323	1301	1199	1191	1197	1203	1289	1373	1380
Gross Margin	27.1%	24.6%	23.3%	21.9%	21.4%	21.8%	20.4%	19.8%	21.2%	21.0%
D&A Exp.	45	82	84	84	83	82	79	82	84	88
Operating Profit	305	348	288	220	138	103	211	157	276	253
Operating Margin	7.8%	6.5%	5.1%	4.0%	2.5%	1.9%	3.6%	2.4%	4.3%	3.9%
Net Profit	223	187	171	201	84	-588	156	203	208	186
Net Margin	5.7%	3.5%	3.1%	3.7%	1.5%	-10.7%	2.6%	3.1%	3.2%	2.8%
Free Cash Flow	202	77	116	136	-13	-285	-756	-1019	-819	-857
Income Tax	94	116	77	-22	23	-1	45	65	64	58

Balance Sheet Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total Assets	2945	3521	3508	3472	3269	2715	2752	2742	2879	2897
Cash & Equivalents	347	137	95	63	96	78	143	142	160	114
Accounts Receivable	586	797	885	827	582	417	449	447	477	547
Inventories	408	722	712	780	761	812	737	786	795	783
Goodwill & Int. Ass.	425	1326	1239	1205	1167	452	420	393	388	350
Total Liabilities	1431	2079	2113	2010	1789	1879	1787	1699	1761	1895
Accounts Payable	323	566	617	610	648	862	609	681	725	745
Long-Term Debt	723	1059	1072	1015	749	588	641	518	532	638
Shareholder's Equity	1514	1442	1394	1462	1477	834	963	1042	1118	1001
D/E Ratio	0.48	0.73	0.77	0.69	0.51	0.70	0.67	0.50	0.48	0.64

Profitability & Per Share Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Return on Assets	7.7%	5.8%	4.9%	5.8%	2.5%	-19.7%	5.7%	7.4%	7.4%	6.4%
Return on Equity	15.0%	12.7%	12.1%	14.1%	5.7%	-50.9%	17.4%	20.3%	19.2%	17.5%
ROIC	10.1%	7.9%	6.9%	8.1%	3.6%	-32.2%	10.3%	12.8%	12.9%	11.3%
Shares Out.	99.1	96.5	94.8	95.3	96.0	97.0	96.0	98.5	97.8	93.7
Revenue/Share	39.23	55.02	58.53	58.71	59.63	58.31	61.16	65.97	66.16	70.11
FCF/Share	2.03	0.79	1.21	1.46	-0.13	-3.03	-7.82	-10.35	-8.37	-9.15

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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