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XRAY - Q4 2014 DENTSPLY International Inc Earnings Call

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OVERVIEW:

Co. reported 4Q14 adjusted net earnings of $86.6m and adjusted diluted EPS of $0.60. Expects 2015 adjusted diluted EPS to be $2.50-2.60.

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PRESENTATION

Operator

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

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

Thank you, Kyle. Good morning, everyone and thank you for joining us to discuss DENTSPLY International's fourth quarter and FY14 results. I'm joined by Bret Wise, DENTSPLY's Chairman and Chief Executive Officer; Chris Clark, our President and Chief Financial Officer; and Jim Mosch, our Executive Vice President and Chief Operating Officer.

I hope you had a chance to review our press release issued earlier this morning. A copy of the release and supplemental slides and information relating to non-GAAP financials are available for download in the Investor Relations section of our website, www.dentsply.com, under the heading, Quarterly Results. And don't forget the Safe Harbor language and US GAAP reconciliation contained in today's release also pertains to this conference call.

We may make forward-looking statements involving risks and uncertainties. These should be considered in conjunction with the risk factors and uncertainties that are described in the release and in our SEC filings. It is possible that actual results may differ materially from the forward-looking statements that we make today.

The Company undertakes no obligation to update or revise any forward-looking statements to reflect events or circumstances that may arise after the date of this call. With that, I'd now like to turn the call over to Bret Wise. Bret?

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

Thank you, Derek, and good morning, everyone. Thank you for joining us again on the call this morning. I have just a few opening comments on the state of the markets, our strategic priorities, and then briefly on the results. Then I'll turn the call over to Jim and Chris, who will provide more details.

First on the markets, generally the trends that we saw earlier in the year continued in Q4. Overall, the global markets were reasonably stable, with the exception of the CIS region which continued in steep decline.

US market certainly is showing signs of life, probably at about the same pace as in Q3 or maybe a little bit better. The European market ex-CIS remained flattish, with some markets growing slowly and some contracting a bit. However, I will say there's a slight bias towards improvement there, the markets that were growing, there are more of them and they were a little bit more robust and there were fewer markets that were contracting.

Rest of world was, of course, a mixed bag. Growth markets continued to be China, select countries in Asia, India, Middle East and Canada., while Australia was stable and Japan and Brazil declined modestly. Overall, I'd say the market trends are very consistent with what we saw earlier in the year, maybe with a slight bias towards getting better.

Moving to DENTSPLY, we entered 2014 focused on new product launches and growth but also on improving our efficiency in terms of operating margins, asset churns and cash flow as priorities. We also established a target to achieve an adjusted operating margin of 20% by 2017 and that was off a 17.6% base in 2013.

So we're looking for approximately 240 basis points of improvement over that period of time. We made some good progress on these priorities in 2014, significantly increasing our operating margins, our asset churns and our cash flow generation.

We are also now moving several elements of the efficiency program from planning to implementation and thus, we expect to see more improvement, substantially more progress over the next eight quarters or so. It's also important to remember that this program is not only about efficiency and cost but it's also about reducing fixed cost in favor of variable spending and investment in growth initiatives, in particular, opportunities we see in research, clinical work and customer-facing areas of our global platform. Overall, there's some good signs of our progress in our reports this past year and we expect to build on those as we move through 2015 and 2016.

Separately, based on our cash flow in 2014, we're now in a good position to redeploy cash to benefit shareholders. You already began to see this in our share repurchase program in 2014 which accelerated notably from prior years and we'll give you more details on that this morning. Of course, acquisitions also remain a high priority for us to the extent we can find attractive returns through acquisition growth as we move forward.

Looking at the numbers, sales growth, ex-PM was up 1.8% in constant currency for the year and the fourth quarter came in at a positive 2.1% constant currency with 1.9% of that being internal growth. Regionally, internal growth in Q4 was strongest in rest of world at positive 3.4%, followed by Europe which was up 2.0% and US was up 0.7% in the quarter, although retail growth was higher than that in the US and you'll hear more about that this morning from Chris and Jim. Looking at underlying demand trends, we expect to see US growth to pick up as we move through 2015 at this point.

Europe was up 2%. Although this is a good number in and of itself, considering the economic conditions, this was still significantly depressed by the CIS region.

Internal sales growth in Europe ex-CIS was up 3.8% and that's the strongest growth we've seen in that region since the beginning of the recession in 2008. This builds on a pretty strong third quarter for us as well in Europe which is, of course, encouraging at this point. However, we continue to believe that growth, our growth there is quite a bit above the market growth and although we see market improvement in 2015 as a distinct possibility in Europe, the risk of economic stability in the region remains very, very high.

Sales in the rest of world were led by strong growth in Asia, modest improvements in Latin America, Canada, and Australia, and were down in Japan and the Middle East.

On a product category basis, our healthcare and dental specialty sales growth was the strongest while chairside consumables, including small equipment were low single digits and lab was negative low single digits.

On earnings, operating margins expanded by 50 basis points in the quarter and were up 80 basis points for the full year. We've shown a pretty consistent trend of improved operating margins throughout the year here. And I think that's a good sign for the impact of the programs we've instituted.

Cash flow also improved significantly, growing to $560 million for the year, that's up 34% compared to the prior year. Again, I think both the margins and the cash flow generation reflect well on the efficiency program and our ability to turn earnings into cash flow as we work toward our long-term ROIC target of 12% to 15%.

Going forward, we're emphasizing new product innovation and launches. A strong platform that we have for clinical education and procedural selling and investment in our sales force to ensure that they're the most knowledgeable group in the field. This combined with our efficiency program and reinvestment of our cash flows set the stage for growing shareholder value over time.

Looking ahead to 2015, we're facing rather severe changes in currency exchange markets, which at the current rates, will impact our results significantly. Derek has included a slide on currency -- the change in currency exchange rates that he posted this morning on the website for you to see.

We have programs in place to mute or offset some of the effects of the rate movements, however, with 66% of our sales in international markets, the impact is still very substantial. At current rates we estimate that currency impacts net of hedging activities is approximately a $0.14 per share drag on earnings in 2015 versus 2014 and again, that's net of our hedging activities.

With this in mind and considering the market conditions and what we can achieve in our efficiency program net of the investments in that program, we're establishing initial expectations for adjusted earnings per share of $2.50 to $2.60 per share.

So before I turn this over to Jim, overall, operationally, we believe the underlying performance of the Company is moving along the trajectory toward the goals we've put forth, namely operating margin expansion, improving our cash flows and improving our ROIC. We're optimistic about market growth expectations in certain key markets for 2015 to help boost results. Jim?

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

Thank you, Bret. I would like to comment on operational highlights for Q4 in 2014 and provide some perspective on 2015 and I'll then turn it over to Chris.

2014 saw lower-than-expected internal growth in the first half of the year and we saw improvement in Q3 and Q4. In the US, we saw good retail growth of our chairside consumables in the mid-single digit range although wholesale growth was muted. More specifically, our restores business saw continued performance from new products, such as TPH Spectra, Prime&Bond Elect, and the Class II marketing campaign, all supporting excellent growth.

In addition, our prevention hygiene business has leveraged new product launches such as NUPRO Varnish and Cavitron FITGRIP, driving growth among consumables overall. This was somewhat offset by lab, which was negative, driven by declines in traditional lab products.

Outside the US, we saw real acceleration in the chairside consumable categories. In Q4, Western Europe internal growth was up mid-single digits and Asia was up double digits, which helped to counter very slow growth in Latin America and contraction in CIS.

Looking to our healthcare business, we continue to leverage previous launches of the [Arego] male catheter, and [Sensfemale] catheter and healthcare grew nicely in the quarter in both Europe and the US. Of the products launched in Q4, we have been very pleased with the success of both the Midwest E Electric Handpiece and TRUShape Dent Retention Endodontic System.

Midwest E has provided an entrance into the growing electric handpiece segment. Response has been excellent and sales were 3X expectations in Q4. In addition, TRUShape has been well received by the endodontic community and the minimally invasive and Dent Retention attributes has resonated with the clinicians.

Turning to our implant business, we've had excellent acceptance of the new ASTRA TECH EV Implant System, which now represents greater than 50% of our ASTRA TECH Implant System, all of which was occurred in the first year of launch. As indicated, we had a delayed start in the US and Germany as the conversion rate exceeded demand, leading to inventory liquidation as clinicians transitioned to the new system.

We forecasted recovery in the back half which we saw in Q3. And Q4 total implant performance improved sequentially to mid-single digits constant currency growth. Our implant performance was driven by growth in the US and Rest of World and Europe was positive despite a 200-basis point headwind from Russia CIS.

In 2014, we completed the integration of our digital businesses which was Atlantis abutments, ISUS bars and bridges, and materialized surgical guides. These products are now being sold by the DENTSPLY implant sales organization. Through this effort, we have seen high single digit growth of our digital portfolio and solid growth in each product group.

As we discussed throughout the year, operational effectiveness was the key focus area. This came in the form of several facility consolidations in US and Europe, cost reduction initiatives and network and capital improvement. These efforts delivered cost savings, gross margin improvement, operating margin expansion throughout 2014.

In Q4, we had solid net working capital improvement with a six-day inventory reduction and operating margin improved 50 basis points and we also had record cash flow. These results added to a good performance throughout the year. Chris will discuss these in more detail.

As we enter 2015, we will continue our operational initiatives and we'll work to deliver operating margin expansion and net working capital improvement. Commercially, we look forward to the IDS in Cologne, Germany in March. As in the past, we will have the DENTSPLY Village, with all dental divisions represented.

New products will be the theme and we expect to launch 12 new products at the show, with some particularly important launches in our lab and endodontic businesses. In addition to innovation, we will focus heavily on expanding and developing our sales organization, and increasing our clinical education initiatives, which we believe are all directly aligned with our success in the market. I'd now like to turn it over to Chris Clark to review the financial results.

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

Thank you, Jim. Good morning, everyone. I'd like to provide some detail on both our fourth quarter and our full-year results by reviewing key elements of our income statement and also providing some additional color on our balance sheet and cash flow. For the fourth quarter, sales excluding precious metals, declined 3.2% compared to prior year, as internal growth of 190 basis points and net impact from acquisitions of 20 basis points were more than fully offset by unfavorable currency translation of 530 basis points.

Internal growth was 0.7% in the US and was negatively impacted by the headwind from channel inventory contractions associated with purchasing ahead of our October price increase that we mentioned on our third quarter call as well as a 180-basis point headwind from lower small equipment sales compared to a very strong prior year base that included a major new product launch.

From a retail standpoint, our growth in the US was much better than this and we expect this to continue as we move in to 2015. European internal growth was 2.0% in the quarter, including 3.8% excluding Russia CIS, which continues to contract well in to the double digits as a result of the economic and political situation there.

For the quarter, Russia CIS was a headwind toward global internal growth figure by approximately 80 basis points. Our Rest of World internal growth of 3.4% in the quarter was led by particularly strong performances in the Pacific Rim, as Bret mentioned. Gross profit on an adjusted basis in the fourth quarter was 57.4% of sales, excluding precious metals, which was an improvement of 90 basis points over prior year and reflects the favorable impact of price, mix, FX, and some of our recent operational improvement efforts, partially offset by lower absorption as we took out inventory in the period.

SG&A expenses on an adjusted basis were 39.6% of sales, excluding precious metals. That's up 30 basis points compared to our rate in the fourth quarter 2013 and includes some heavier spending associated with our operational improvement initiatives, consistent with our comments on the third quarter call.

Operating margin for the quarter improved by 50 basis points to 17.7% of sales, excluding precious metals, on an adjusted basis. That compares to 17.2% in the fourth quarter last year and reflects the gross margin SG&A impacts that I just described.

Currency represented a headwind to earnings in the quarter of between $0.02 and $0.03 per share and that was approximately $0.0075 worse than what we anticipated on the third quarter earnings call as the US dollar strengthened subsequent to that call and drove an incremental unfavorable translation headwind.

Our reported tax rate and for the fourth quarter was 11.9% while our operating tax rate was 22.1%, which was 130 basis points above our fourth quarter rate last year. You'll recall that we mentioned on our third quarter call that we anticipated an unfavorable comparison to prior year quarter in the tax line primarily as a result of unfavorable geographic mix.

Net income attributable to DENTSPLY International on an as reported basis in the fourth quarter was $84.7 million, or $0.59 per diluted share and that compares to $74.4 million, or $0.51 per diluted share in the fourth quarter of 2013. These results include a number of items which we've listed in the schedules in the release.

On an adjusted basis, net earnings were $86.6 million in the quarter, down slightly from $87.9 million from the prior year quarter. Adjusted diluted EPS was $0.60 per share, down from $0.61 last year.

Our results include the headwinds that we anticipated on our third quarter call, including currency, tax, incremental investments to support our operating and margin improvements, and a modest contraction of channel inventories as a result of purchases ahead of the October price increase, although the net impact of these items was probably a bit worse than what we anticipated.

Transitioning now to the full year results for 2014, sales, excluding precious metals, grew 0.8% compared to prior year, including 120 basis points of internal growth, 60 basis points from net acquisitions and negative currency translation impact of 100 basis points. The headwinds in CIS had a negative impact on internal growth of 70 basis points on our global number for the year and after providing a pretty nice benefit to internal growth in 2013.

For the year, the US comprised 34% of our global sales while Europe represented 45% and the Rest of World region represented 21%. Operating margin for the year improved 80 basis points to 18.4% of sales, excluding precious metals, on an adjusted basis; that compares to 17.6% last year. We're pleased with this improvement in operating leverage, particularly given the slower than ideal market conditions that we faced during much of the year, particularly in Europe.

On an adjusted basis, net earnings on the -- for the year increased to $361 million from $341.2 million in 2013. And adjusted earnings per share grew 6% to $2.50 per diluted share from $2.35 per diluted share in 2013.

Our results for the year include a negative impact from currency of approximately $0.04 per share, which is generally in line of what we anticipated in our initial guidance for the year. Based on current rates, currencies are a much larger headwind for us in 2015 and I'll describe that in more detail in a moment.

Moving on to cash flow, our operating cash flow for the year was a record $560.4 million. It's up 34% from $417.8 million last year. While free cash flow, which we define as operating cash flow less capital expenditures, grew 45% to $461 million from $318 million a year ago.

This improvement reflects earnings growth in the improved working capital performance and also continued tax benefits associated with recent acquisitions. As a result, our free cash flow conversion was strong at 143% of reported net income for the year while our trailing 12-month free cash flow yield now stands north of 6%.

Our cash flow performance allowed us to continue to take a more balanced approach to capital deployment as we move through the year, including acquisitions and share buybacks. In the fourth quarter, we completed one acquisition in Europe as well as two small divestitures, one in the US and one in Europe. None of these are material to our financial results.

In the fourth quarter, we also accelerated our share repurchases by buying back over 1.7 million shares in the quarter at an average cost of $52.88 per share. For the full year, the Company repurchased approximately 3.3 million shares. We ended 2014 with a net debt to capitalization ratio of 32.4% compared to 35.2% at the end of 2013 and 48.2% right after the ASTRA TECH acquisition.

Looking forward, our balance sheet provides us considerable flexibility to deploy capital through acquisitions and share buybacks. Inventories now stand at 113 days, which is down six days compared to September, down 10 days from June, and down one day compared to December 2013.

For the year, our inventory pattern was pretty consistent with what we anticipated, as we had indicated that inventories would drop in the second half of 2014 after increasing previously as a result of transition plans associated with anticipated operational changes.

Looking ahead, we anticipate continued progress in this area of recognizing that there is some seasonality to our inventory patterns as inventories will tend to increase a bit in the first half of the year. Accounts receivable days were 55 days at the end of December, that's down seven days from prior quarter and down one day compared to December 2013.

Capital expenditures for the year totaled $100 million while depreciation was $81 million and amortization was $48 million. As we move in to 2015, we're pleased with the operating performance of the business, particularly the improvements driving our operating margin rate and cash flow performance.

While our assumptions for 2015 include continued improvements in both these areas, we're also reflecting a series of unprecedented moves in foreign currency rates over the last 60 days, including significant strengthening of the US dollar against most major foreign currencies, as well as significant weakening of the Euro relative to the Swiss Franc.

The US dollar is now 14% stronger relative to the Euro than it was on average in 2014, with similar strengthening across the other key currencies including the Swedish Corona, Canadian Dollar, Australian Dollar and British Pound. At current rates, these rates would create an unfavorable impact to our sales results for 2015 of over 800 basis points.

With respect to earnings, at current rates, the impact of adjusted EPS for 2015 would be approximately $0.14 per share, reflecting a substantial benefit from our cash flow hedging program. Absent the impacts on the hedges, the earnings headwind from FX would be about double the $0.14 that we're currently facing.

These hedges helped to partially bring our FX impact over a rolling 18-month period. While they do not eliminate or reduce the long-term impact of currency changes, they do reduce the volatility by essentially gradualizing rate changes.

Longer term, one target benefit of our operating margin improvement initiative is a standardized production processes across similar facilities, allowing us to flex a portion of our production between plants and geographies based on a number of factors, including currency movements. In the near term, we're accelerating targeted actions to address specific costs and pricing opportunities as a result of the currency challenge.

As we provide our 2015 earnings guidance, I want to point out that this is on a non-GAAP basis and excludes the impact of amortization, restructuring-related activities, and fair market value adjustments on derivatives, financial instruments and pensions. As Bret stated, we are establishing our 2015 earnings per share guidance of $2.50 to $2.60 on an adjusted basis.

Our guidance reflects the impact of the incremental currency headwind of approximately $0.14 per share and the non-GAAP adjustments that I mentioned earlier. In addition, our guidance reflects an anticipated 50 basis point headwind in our 2015 tax rate compared to 2014's rate and that's a result of projected unfavorable geographic earnings mix. There may be some opportunity to improve on the tax rate as we move through the year. We'll just have to see.

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

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator instructions)

Robert Jones, Goldman Sachs.

Nathan Rich - *Goldman Sachs - Analyst*

Hi, this is Nathan Rich on for Bob today. Chris, first question for you. You just mentioned the ability to maybe shift manufacturing and costs across geographies to offset some of the FX impact. I was just wondering if you could maybe give us a little bit more detail on how big of an opportunity is this and is there any benefit from doing this assumed in your guidance?

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

Yes, Nathan, as we look at that, that's certainly one of the longer-term objectives associated with the operating margin improvement initiative. As we look at it, we have plants that make similar products, not always necessarily the exact same product or using the exact same process in terms of manufacturing process.

So one of our objectives of the initiative is, frankly, to standardize that on a much more common basis, allowing plants that are producing similar products to actually produce the same products in the same manner and that would allow us, over time, to flex production back and forth on a number of different factors, including FX. I would say that we have some limited capability today to do that. I would say that, that's a longer-term objective and while there may be a little bit of help in that in 2015, I'd say that's really more of a longer-term benefit that we see from the program.

Nathan Rich - *Goldman Sachs - Analyst*

Great. Thanks. Then Bret, you talked about US growth being a little bit soft and I understand, I guess there was some pull forward ahead of the price increase in October. Could you just maybe talk about your expectations for 2015 in the US? Do you see that internal growth rate kind of improving throughout the year? Then also internationally, just kind of any impact on sales and earnings cadence around the IDS Show?

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

Okay, Nathan. Quickly, our US growth was muted for the reasons that both Jim and Chris covered. I do think that the US market has accelerated somewhat as we move through the year and there's no reason not to expect it won't accelerate going forward.

And that's why in our comments, we said we expect our own internal growth in the US to accelerate as we move through 2015. So we're reasonably comfortable with that. On international and the effects of the IDS, the IDS is not a big selling show for consumables, meaning we go to the show, we demonstrate our new products.

And then over subsequent months or subsequent quarters, we try to get back to those dentists or those customers and re-engage on the new technology. So we don't usually see a big boost in short-term growth from the IDS. In fact, what we see is a big boost in spending for the IDS. It is quite an expensive show.

So if we look at first quarter, our first quarter, it's probably going to be the most challenging quarter we have for the reasons stated there that we're likely -- I think that US growth will accelerate growth through the year. That will help us. That's probably more back-end loaded than front-end loaded.

Spending will probably be front-end loaded, both on the efficiency programs and on trade shows, the IDS being the largest. But it usually doesn't result in a quick ramp-up in sales. It's more a precursor to sales later in the year.

Nathan Rich - *Goldman Sachs - Analyst*

Great. Thanks for the color.

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

Thank you.

Operator

Jeff Johnson, Robert Baird.

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

Thank you. Good morning, guys. How are you?

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

Good morning, Jeff.

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

Good. Just wondering, Chris, maybe we could just start on the Russia CIS. You've been helpful the last few quarters providing the breakout there. But we're starting to bump up against much easier comps there. Are we -- should we still expect down on top of down comps over the next few quarters? Just what's going on in that business? Obviously, the geopolitical stuff is still an issue there.

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

I think you had a couple factors going on. Obviously, it is very unstable from an economic situation. We think that the demand levels are continuing to drop. Certainly, we're not seeing any sequential improvements if they're continuing to decline double digits and so from that angle, I think that's an indication that it really has not stabilized.

First quarter, we began to run up against the base so from that angle, we're running against a base that declined as opposed to base that improved but I guess I would say that, that basis continued to decline subsequent three quarters. So again, I guess all I can say at this stage is it's highly uncertain and certainly, we would hope that it stabilizes and that's historically been a nice growth market for us but it's been a pretty significant headwind and I don't know that, that's going to flip around any time soon.

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

All right. That's helpful. And then Bret, maybe going back to some of your comments on the first questions that are around margins. Margins continued to impress this quarter. I think it's seven straight quarters here that you guys have put up very solid margin improvement. Is it fair to think though we have to think of those margins kind of flattening out?

I'm just trying to read your comments on the IDS spending and that kind of improvement on the US organic throughout the year. Would it be kind of flat to start the year and then some nice expansion as we exit the year? How to think about that margin gating?

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

Thanks, Jeff. I think for the full year, we're comfortable in saying we're going to see continued margin improvement in 2015. That's -- part of that is our self-help program and part of that is, I think, the opportunity for faster growth in the US, in particular. I do think quarter to quarter, it's always hard to predict. First quarter, I think, is going to be the most challenging for the spending that you commented on. So I don't really have high expectations for the first quarter for margin improvement. I think it will be more back-end loaded in the year this year.

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

That's helpful. And then my last question, Chris, just back on the FX issues for the year. It sounds like you're saying that about 50% of the impact flows through this year and obviously, currency is going to be volatile over the coming months and quarters in that, I'm sure.

So is that kind of a flow through rate we should be thinking of? I know it's varied anywhere from 50% growth to 100% growth over the last few years. Is that hedging in place 50% number right at this point?

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

At this point in time, Jeff, that's correct. Recognize that the caveat that this is highly volatile, right? I mean, these are flipping around significantly, constantly, almost hour by hour.

So yes, as we sit here today, we think the headwind is approximately $0.14 in terms of earnings at current rates for the impact on 2015, but that includes about that size of benefit in that net number from cash flow hedges. Those cash flow hedges, again, as they begin to anniversary themselves, they go away. So again, the gross number -- the gross impact is basically close to double that $0.14.

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

Thanks, guys. Got it. Thanks.

Operator

Steve Beuchaw, Morgan Stanley.

Steve Beuchaw - *Morgan Stanley - Analyst*

Thanks for taking the questions. I had one longer-term cash flow question, I guess that would be for Chris. You guys have given us a pretty helpful road map for how you think about margins improving over time. The cash flow improvement in 2014 was obviously very strong.

Would you be willing to speak to a longer-term view, maybe through 2017, just to be consistent with the commentary on the margin improvement, thinking about how you can grow either operating or free cash flow over that period of time?

We know margins keep improving but obviously, you've had some improvements on the balance sheet as well. Can you give us a sense for how that flows from here? Thanks.

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

Yes, I guess I would say, Steve, that as we think about the objectives of our self-help program, as Bret describes it, obviously, margins are certainly one of that. And the other piece, frankly, is to continue to improve our ROIC and by basically impressing the asset base including working capital.

We think we have opportunities over time to continue to improve on the working capital side. Again, that's going to be a gradual improvement, but we think that we showed some improvement, solid improvement in 2014. We're hoping to continue, we expect to continue to drive that in 2015 and beyond. So I think that as we think about the cash flow opportunities, I think the cash flow opportunities are really twofold.

Number one, improved earnings as a results of the operating margin improvement, and then secondly, the improvements in net working capital over time. So again, I think that growth certainly drives it, as well, I guess would be the third factor in the context of as markets improve and internal growth improves, and that's obviously a factor as well. So those three things would cause me to say over time, we would expect that to improve.

Steve Beuchaw - *Morgan Stanley - Analyst*

And then one follow-up on implants. I wonder if you'd be willing to give us any geographic and deconstruction of how the growth was looking in your implant business toward the end of the year, how you see it in to next year? While we're on the topic of implants, given the amount of strategic activity going on in the implant market, are you seeing any opportunities for commercial traction, incremental share gains or maybe a bit of opportunity to capitalize on attrition given the amount of activity out there? Thanks.

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

Yes, Steve, this is Jim Mosch. As I mentioned in my comments, I think one of the things that we relied on significantly in 2014 was the EV launch. As I mentioned, we've probably hit about 50%, little more than 50% conversion level of that system. I would also say that, that's been pretty evenly distributed.

We saw continued sequential growth in the US, so we're kind of pleased with that position. I think we recognized that we needed improvement in that area from earlier in the year. We saw that in Q3 and Q4 and we expect that to continue in to 2015.

Likewise, Europe was strong ex-CIS. CIS has been a challenge. It's a pretty sizable market for us. We don't expect to see a lot of improvement in that situation in 2015. As Chris mentioned, it's very, very volatile.

From the Rest of the World situation, we've seen improvement in Pacific Rim from -- through 2014. So as I look at it, I believe that we're well positioned. We're seeing nice growth in our digital portfolio. We have continued traction in the EV system. And we would to expect to continue to improve in the overall implant business.

On the commercial side, we will -- I think we're going to be absorbing EV, really throughout 2015. We do have some new opportunities. We will have some product additions that we'll show at the IDS as it relates to Atlantis and our digital portfolio and we expect to kind of get some continued growth from that segment. But as far as a major commercial shift, I don't see anything on the horizon.

Steve Beuchaw - *Morgan Stanley - Analyst*

Very helpful. Thanks, Jim.

Operator

Brandon Couillard, Jefferies.

Brandon Couillard - *Jefferies & Company - Analyst*

Thanks. Good morning.

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

Good morning, Brandon.

Brandon Couillard - *Jefferies & Company - Analyst*

Bret, back on the US business, just to make sure I heard this right. Did you say that the handpiece comp was a 180-basis point headwind in the fourth quarter? And then could you parse out just the chairside consumables trend and how that shaped up in the fourth quarter relative to sort of the run rate we've seen the last three periods?

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

Sure, Brandon. I'll take a shot at that and Chris may need to interject here as well. On the small equipment decline year over year, there's a couple factors there.

One is that we had a large launch last year; it was the Aquasil Cordless was the launch. That's a piece of equipment that goes along with impression material suite of products, let's call it. That was very successful last year and created a big baseline for us to get over this year.

But secondly, we saw small equipment generally slow down in the fourth quarter and diverge from the growth rate of consumables. That happens from time to time but not that often. When it does diverge significantly, we call it out.

I would assume that's temporary and probably going to play itself out here over the next few quarters as those two growth rates in consumables and small equipment kind of return to a common norm. As far as consumables themselves, the chairside consumable component of our business grew retail quite nicely in the fourth quarter. I would say kind of at an accelerating pace.

Now it was -- (inaudible) hidden by the small equipment impact and also the slight destocking coming out of the third quarter price increases. But I think Jim commented that we're in mid-single digits in those products. We had some encouraging reports on that market from one large distributor earlier in the month. Like we mentioned, we expect -- we think that consumables segment is going to accelerate going in to 2015 in the US. We're reasonably optimistic about that market.

Brandon Couillard - *Jefferies & Company - Analyst*

Thanks. And then Chris, in terms of the outlook for next year, can you give us some parameters around operating cash flow in CapEx and then just to clarify, does the guidance contemplate any contribution from incremental share repurchases?

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

Okay. The guidance at this point basically includes the share repurchase that had been done as well as offset of future equity dilution. So from that angle, that's pretty consistent with the way we've -- we typically provide guidance at the beginning of the year. CapEx, at this point, I would estimate we're forecasting $110 million range for the year.

And relative to cash flow, I would expect -- I mean, obviously, we're coming off an enormous base. I would expect a modest improvement, slight improvement for the year as we continue to make improvement in terms of working capital. But again, that would probably not be the same level of improvement that we saw in terms of 2014 over 2013.

Brandon Couillard - *Jefferies & Company - Analyst*

Super. Thank you.

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

You bet.

Operator

John Kreger, William Blair.

John Kreger - *William Blair & Company - Analyst*

Hi, thanks very much. The 1.9 % organic constant dollar growth that I think you had in the fourth quarter, can you give us a sense of what the price component of that was?

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

Yes, as we look at it, let me answer the question, John, via the margin line, which did improve obviously about 90 basis points in the quarter. Price was a component of that. We did take our -- typically we take our price increases on many of our businesses October 1.

Our price increase overall was in the 1.5% range on a -- and we think that most of that appears to have stuck at least in the quarter. So again, that's not on all of our businesses globally but that's on, again, our US consumables business and several of our international businesses. So again, there's no doubt that price is a component of the 1.9% growth but I wouldn't say it's every bit of it.

John Kreger - *William Blair & Company - Analyst*

Great. Thanks. So Chris, given that, can you just talk a little bit more about this destocking effect that you saw in the US? I assume that's behind you. Do you feel like inventory levels out in the channel are pretty reasonable and stable or might we see any more of that as we move through early 2015?

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

No, we think at this point, John, we're kind of entering the year at a pretty normal basis. We called on the third quarter call that we thought that, again, a few of the distributors might run a little bit deeper, if you will, in terms of price increase pre-buy activity in the quarter.

Interest rates were low and that gives them -- obviously, as we take price increases, that's how they put it through their models and make a determination in terms of what their return in terms of going deeper on key products might be. We called that out in terms of it being a potential impact. Obviously, it's always a little bit hard to tell the exact amount of that.

But again, that happened -- that was pretty much in line, I would say, in the fourth quarter with what we anticipated on the third quarter call and again, we think we're entering on balance, entering the year, again, in a pretty stable position. Again, there's going to be individual businesses, plus and minus, and individual geographies, plus and minus, but I think overall, pretty balanced.

John Kreger - *William Blair & Company - Analyst*

That's helpful. Thanks. Maybe one last one. Particularly in the US and Europe, do you have any visibility to the underlying customer type and what sort of growth you're seeing into, let's say, the smaller practice versus larger or/and corporate accounts? Are you seeing any differential in growth rates into those two classes?

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

Yes, as it relates to that, we certainly recognize that in certain geographies, we see it in the US, we see a little bit in the UK, we've seen a little bit of activity in Canada, there's kind of this rise of corporate dentistry.

I would say that we've had very favorable impact in those type of customers because we have such a broad portfolio and we're able to leverage that portfolio and our clinical education programs to be able to address the needs of those type of practices.

I wouldn't say at this point in time, we've seen such a shift that it's made a major change or we see a major shift between group or corporate customers versus individual practices. We haven't seen that phenomenon as of yet.

John Kreger - *William Blair & Company - Analyst*

Great. Thank you very much.

Operator

Jon Block, Stifel.

Ethan Roth - *Stifel Nicolaus - Analyst*

Hi, thanks. This is Ethan Roth on for Jon. The implant business was up mid-single digits now for the second consecutive quarter. Last quarter, you provided some commentary on the ASTRA TECH EV System and mentioned that one-third of conversions were coming from new customers. Are you still tracking to similar levels of competitive conversions?

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

Yes, Ethan, I'd say that's probably fallen off a little bit and it's primarily as we've gotten into the larger markets of the US and Germany where we obviously have much larger businesses, much larger number of customers.

So there's really a capacity issue over our ability to address the needs of those customers. However, we are still seeing a good number of conversions of new customers with our EV system. But I would not say it's at that one-third level.

Ethan Roth - *Stifel Nicolaus - Analyst*

Okay. Great. And then just on the 2017 operating margin goal of 20%, what impact, if any, has the current changes and the FX had on that and if you're still maintaining that target, does that imply modest improvement you're thinking just on the core margin expansion? Thanks.

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

As we look at 2014, FX was actually a little bit of a headwind, slight headwind overall for the year in terms of the operating margin rate. As we look to 2015, at current rates, it's actually going to flip around and be a bit of a help as the drag on the top line is going to be a little bit more than the drag on the bottom line.

As we think about the 20%, our effective is 20% in 2017 regardless of the FX situation. And so again, I do think that there may be a little bit of a noise, give or take here, as we have individual periods with FX changes but again, I think the key core for us is to keep on focusing on the underlying improvement of the business and obviously, we're pleased with the progress in 2014.

Operator

Steven Valiquette, UBS.

Steven Valiquette - *UBS - Analyst*

Thanks. I literally had the exact same question that was just asked. So I'm all set now. Thanks.

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

Thanks, Steve.

Operator

Erin Wilson, Bank of America.

Erin Wilson - *BofA Merrill Lynch - Analyst*

Thanks for taking my questions. In implant, have you seen any sort of meaningful changes in pricing or the competitive dynamics across the implant business in light of industry consolidation? How do you envision that market evolving over the next year but also longer term? And can you speak to high end versus value as well?

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

Certainly. From a standpoint of meaningful change pricing-wise, we've not seen that to date. In fact, as we look at the premium implant segment, one phenomena we have seen is that implant unit growth has increased. Certainly, it's taken a couple years for that to happen. The other thing we see is average sell prices are fairly stable.

In some cases, we're seeing increases. So from a standpoint of the premium implant segment, it is definitely improving. I think you see that in the performance of certainly some of our competitors.

The industry consolidation you speak of, obviously that is actually happening as we speak. So I don't think we've yet to see the full impacts of what will happen with Nobel and Zimmer 3i. I think that will come down the road. As far as the longer period of time, I think that's a little difficult to predict.

Certainly, we recognized that in certain geographic segments, value is very important. Value implants are very important and you need those systems to have access to the broader market and certainly we will look at those opportunities.

Erin Wilson - *BofA Merrill Lynch - Analyst*

Okay. Great. On capital deployment, what are you looking at from an acquisition standpoint? Do you anticipate greater opportunities in 2015 relative to 2014? What types of acquisitions would you be potentially targeting here?

And on the flip side of that, should we anticipate any further divestitures or deemphasis of certain product lines as part of your operational initiatives and would that be incorporated in to your guidance? Thanks.

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

Erin, on acquisitions, both acquisitions and divestitures we haven't done yet, are not incorporated into our guidance at all. I would say that we're a little bit more optimistic about acquisitions, the ability to execute acquisitions in 2015 than we were in 2014. So we're actively involved in that.

I think predicting how much and when is a dangerous game because there's a huge timing risk and execution risk on acquisitions. But I think it's fair to say that we're interested in growing by acquisition.

Our balance sheet is really in pretty good shape right now. We've said in 2014, we're repeating in 2015 to the extent there aren't acquisitions, we're likely to be more active in share buybacks. You saw us picking up the pace in share buybacks in 2014 as well.

So to us, it's kind of an either/or type equation right now. To the extent there's transactions available, we'll probably transact them. It's important that they fit in to our timing for the efficiency program as well, meaning, they're stable enough that we can leave them outside of the efficiency program for awhile or they could easily be integrated while we're doing efficiency program as well. So we take that in to account as another factor. But I think we're more optimistic about the ability to deploy cash to create shareholder value than we have been for some time in the business.

Erin Wilson - *BofA Merrill Lynch - Analyst*

Okay. Great. Thanks so much.

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

Thank you.

Operator

I would now like to turn the conference back over to our speakers for any additional or closing remarks.

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

Okay, thank you all for your interest in DENTSPLY. That concludes our conference call. If you have any other questions, I'm available today for follow-up. I look forward to seeing many of you at the upcoming dental shows in Chicago and at the IDS. Thanks a lot. Bye.

Operator

This does conclude today's conference call. Thank you all for your participation. You may now disconnect.
