IDEXX Laboratories, Inc.

Q3 Fiscal Year 2023 Earnings Call – Prepared Remarks

Introduction

IDEXX would like to preface the discussion today with a caution regarding forward-looking statements. Listeners are reminded that our discussion during the call will include forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those discussed today. Additional information regarding these risks and uncertainties is available under the forward-looking statements notice in our press release issued this morning, as well as in our periodic filings with the Securities and Exchange Commission, which can be obtained from the SEC or by visiting the Investor Relations section of our website, IDEXX.com.

During this call, we will be discussing certain financial measures, not prepared in accordance with Generally Accepted Accounting Principles or GAAP. A reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures is provided in our earnings release, which may also be found by visiting the Investor Relations section of our website.

In reviewing our third quarter 2023 results, please note all references to growth, organic growth, and comparable growth refer to growth compared to the equivalent period in 2022 unless otherwise noted.

Brian P. McKeon
Executive Vice President, Chief Financial Officer

Good morning and welcome to our third quarter earnings call. Today — I'll take you through our Q3 results and review our updated financial outlook for 2023.

In terms of highlights — IDEXX achieved solid revenue growth and strong profit gains in the third quarter.

- Overall revenues increased 8% organically — supported by 9% organic growth in CAG Diagnostics recurring revenues, net of ~50 basis points of negative impact from fewer equivalent selling days.

- Organic revenue growth was supported by sustained benefits from IDEXX execution drivers – including continued strong premium instrument placements, solid new business gains, high levels of customer retention and high growth in recurring veterinary software revenues.
- Overall CAG Diagnostics recurring revenue gains in the quarter were moderated by a 2% same-store decline in U.S. clinical visits. This was below our expectations for relatively flattening U.S. clinic visit trends — reflecting ongoing capacity management challenges at U.S. clinics and relatively softer wellness visit levels.
- Operating profit results were ahead of our expectations, supported by gross margin gains and operating expense leverage — which enabled EPS delivery of $2.53 per share, up 18% as reported and 16% on a comparable basis.

Based on our strong financial results in the quarter — we're updating our full-year EPS outlook, aligned with the higher end of our previous guidance range. This reflects expectations for strong comparable operating margin gains this year. We're also updating our full-year revenue guidance ranges to incorporate our Q3 results and recent sector trends, as well as to reflect the recent strengthening of the U.S. dollar.

We'll review our updated guidance detail later in my comments. Let's begin with a review of our third quarter results.

Third quarter organic revenue growth of 8% was driven by 8% organic CAG gains and 7% organic growth in our Water business. Overall organic revenue growth was moderated by 2% organic growth in our LPD business and ~$3 million of headwind related to lower OPTI Medical revenues, including effects from the wind down of our human Covid testing business.

CAG Diagnostics recurring revenue increased 9% organically – reflecting 8.3% gains in the U.S. and 10.3% growth in International regions, net of a 0.5% global growth headwind from equivalent days effects. CAG Diagnostics organic recurring revenue growth in Q3 was supported by average global net price improvement of ~7%, in line with our expectations for 6%-7% gains in the second half of this year.

Overall organic revenue growth was supported by 13% organic growth in veterinary software and diagnostic imaging revenues — driven by continued strong gains in recurring software revenues. CAG instrument revenues were down 10% organically, reflecting comparisons to high prior year levels, program pricing effects and global mix.

IDEXX CAG Diagnostics recurring revenue growth remained solidly above sector growth levels.

In the U.S., CAG Diagnostics recurring revenue organic growth was 8.3% including ~50 basis points of negative impact from fewer selling days in Q3. This reflects an approximate 1100 basis point normalized growth premium compared to same-store U.S. clinical visit growth levels, which declined an estimated 2% overall in the quarter. IDEXX's growth results reflected continued increases in diagnostics frequency and utilization per clinical visit at the practice level — and strong benefits from IDEXX execution drivers — including higher net price realization, solid new business gains, and sustained high customer retention levels.

As noted, same-store U.S. clinical visit declines of 2% were below our expectations for relatively flat clinic visit growth in the second half of 2023. Softer trends in Q3 appear to have been impacted by ongoing capacity management challenges at U.S. clinics, including effects from high staff turnover. We also saw a relative slowdown in wellness visits in the quarter — which may reflect some macro impacts on demand at the clinic level. We've refined our full year revenue outlook to capture potential impacts from these trends in Q4 — while reinforcing our strong outlook for 2023 profit performance.

IDEXX International CAG Diagnostics recurring revenue organic growth was 10.3% in Q3 — reflecting continued benefits from higher net price realization and improved volume gains. International results were also supported by strong IDEXX execution – reflected in sustained new business gains and high Q3 premium instrument placements, which supported a double-digit expansion of our premium instrument installed base. Double-digit growth rate benefits from IDEXX execution offset negative impacts from international macro conditions — which continued to pressure same-store volume growth trends in the quarter.

Globally — Q3 results were supported by strong growth of IDEXX in-clinic CAG Diagnostics recurring revenues.

IDEXX VetLab® consumable revenues increased 11% organically — with double-digit gains in U.S. and International regions. Consumable gains were supported by 11% year-on-year growth in our global premium instrument installed base — reflecting strong gains across our Catalyst, premium Hematology and SediVue® platforms. We placed 4,571 CAG premium instruments in Q3 — a decrease of 4% year-on-year compared to record prior year levels — which included benefits from our international launch of ProCyte One®. The quality of instrument placements continues to be excellent – reflected in solid global gains in EVI metrics and sustained high new and competitive Catalyst placements in the U.S. Global Catalyst placements decreased 2% overall — reflecting tougher comparisons to high prior year International placement levels. ProCyte One® installed base expansion continued at a solid pace – reflected in a global installed base of over 12,000 instruments.

Global Rapid Assay revenues expanded 8% organically in Q3 — supported by strong growth in the U.S., including benefits from higher net price realization.

Global lab revenues increased 7% organically – reflecting high single-digit gains in the U.S. and relatively improved, mid-to-high single-digit growth in International regions.

In other areas of our CAG business – Veterinary Software and Diagnostic Imaging revenues increased 13% organically. Results were supported by continued high levels of organic growth in recurring software and diagnostic imaging revenues – and ongoing momentum in cloud-based software placements.

Water revenues increased 7% organically in Q3 – compared to strong prior year growth levels. Growth was driven by continued solid gains in the U.S., including benefits from net price improvement. Our Tecta-PDS acquisition integration continues to progress well — and added ~1% to reported Water growth.

Livestock, Poultry and Dairy revenues increased 2% organically — as strong gains in the U.S. continue to be moderated by constraints on International growth, including impacts from lower herd health screening revenues related to reduced China import testing.

Turning to the P&L – Q3 profit results were supported by high comparable operating margin gains, including benefits from operating expense leverage.

Gross profit increased 8% in the quarter as reported and on a comparable basis. Gross margins were 59.9% — up 30 basis points on a comparable basis, compared to strong prior year levels. Gross margin gains reflected benefits from higher net price realization, business mix and improvement in software service gross margins. As expected, reported gross margin gains were moderated by a 60-basis point negative impact related to FX, driven by the lapping of prior year hedge gains. We're projecting an approximate 70 basis point gross margin headwind in Q4 related to FX, again primarily related to lapping of prior year hedge gains.

On a reported basis — operating expenses increased 4% year-on-year as reported and on a comparable basis, reflecting benefits from cost controls and lapping of prior year R&D and commercial investments. We're planning for a higher level of opex growth in Q4 as we advance our U.S. commercial expansion and increase R&D investments aligned with our innovation initiatives, including our planned 2024 new platform launch.

EPS was $2.53 per share in Q3, an increase of 18% as reported and 16% on a comparable basis. Foreign exchange reduced operating profits by $1 million and EPS by $0.01 per share in the quarter, including impacts from the lapping of $9 million in prior year hedge gains. Impacts from 2023 foreign exchange hedges resulted in a $1 million gain in the quarter.

Free cash flow was $238 million in the third quarter. On a trailing 12-month basis, our net income to FCF conversion ratio was 83%. For the full year, we're updating our outlook for free cash flow conversion to 85% - 90% of net income — at the higher end of our earlier projections — reflecting estimated capital spending of $160 - $180 million.

Our balance sheet remains in a strong position. We ended the quarter with leverage ratios of 0.8x gross and 0.6x net of cash. Share repurchases over the last year supported a 0.1% reduction in diluted shares outstanding for the quarter. We allocated $35 million in capital to share repurchases in the third quarter, as we continue to manage our balance sheet relatively more conservatively in the current interest rate environment.

Turning to our 2023 P&L guidance – we're updating our full-year outlook to incorporate our Q3 results and revised estimates for foreign exchange impacts, reflecting the recent strengthening of the U.S. dollar.

Our updated full-year guidance for reported revenues is $3,635 million - $3,650 million, reflecting a 7.9% to 8.4% reported growth range. The updated reported revenue outlook includes a $20 million reduction for FX impacts compared to prior estimates. We now estimate

FX will reduce full-year reported growth by approximately 0.5%, with limited year-on-year revenue growth effects in Q4.

In terms of our operational revenue growth outlook — we are updating our full-year organic growth guidance to 8.3% to 8.8%, supported by an outlook for CAG Diagnostics recurring revenue organic growth of 9.8% to 10.3%. This aligns with the lower end of our most recent guidance ranges — and the midpoint of our original outlook for 2023. Our organic growth guidance assumes a level of continued pressure on U.S. same-store clinical visits and International same-store sales levels in Q4 — reflecting ongoing clinic capacity management dynamics and macro-economic impacts on demand. Consistent with earlier guidance — our outlook for CAG Diagnostics recurring revenue growth reflects continued solid, positive benefits from IDEXX execution drivers — including consistent expectations for 6%-7% net price improvement in the second half of 2023. In Q4, we expect global net price improvement within this range, with U.S. net price gains of ~6%, reflecting the lapping of prior year price increases. Our Q4 outlook also incorporates a 1% equivalent day volume growth headwind.

We're maintaining the high end of our reported EPS outlook — and narrowing the full-year EPS guidance range to $9.74 to $9.90 per share, an increase of $0.05 per share at midpoint. At midpoint — we're maintaining a consistent operational EPS outlook, as revisions to our organic revenue growth range are offset by positive adjustments to our projections for operating margins — incorporating our strong year-to-date performance. We've increased the outlook for reported operating margins to 29.6% - 29.8% for the full year. This reflects an outlook for 360-380 basis points in comparable operating margin expansion – including ~280 basis points in combined benefit from the $16 million Q1 customer contract resolution payment and the lapping of $80 million of discrete R&D investment in the second quarter of 2022.

Our updated full year EPS guidance incorporates ~$0.11 per share in positive revisions combined to our interest expense and tax rate outlook — including ~$0.04 in upsides related to share based compensation tax benefits. These gains are partially offset by ~$0.05 of negative impact from foreign exchange changes at updated rates. We now estimate that foreign exchange impacts will decrease EPS by ~$0.25 per share for the full year — and will reduce reported full year operating margins by ~70 basis points — including impacts from the lapping of $26 million in 2022 hedge gains.

We've provided details on our updated 2023 outlook in the press release tables and earnings snapshot.

That concludes our financial review. I'll now turn the call over to Jay for his comments.

Jay Mazelsky
President & Chief Executive Officer
Thank you, Brian, and good morning.

IDEXX continued to make excellent progress in advancing our business strategy in Q3 while delivering solid organic revenue growth and strong financial performance. Our strategy of high-touch commercial engagement, supported by relevant testing and workflow innovations, drove continued adoption of IDEXX's world class products and services. IDEXX solutions support our customer's mission to deliver high standards of care, enabled through the continued expansion of diagnostics frequency and utilization at the practice level. Diagnostics revenue remains the fastest growing area of veterinary clinic revenues – a durable trend since the determination of a patient's health status and the best treatment path very often requires testing.

IDEXX's strong financial performance in Q3 was supported by solid gains in CAG Diagnostics recurring revenues across our major regions. The expansion of recurring revenues benefit from multiple IDEXX execution drivers, including solid placements of premium instruments building off high prior year levels, sustained new business gains, net price realization, and continued momentum in placements of cloud-based software solutions. These gains are offsetting nearterm headwinds in overall clinic visit levels globally – reflecting ongoing capacity management challenges at veterinary practices, as well as impacts from macro-economic dynamics. Productivity remains a top priority for veterinary clinics, who continue to refine their business approach and make trade-offs necessary to balance staffing management challenges with strong demand for medical services. IDEXX's solutions — anchored by our software-enabled multi-modality offering — give clinics the tools to address these dynamics.

Today, I'll review how we're advancing our strategy focused on developing the significant long-term growth opportunity for our business — while delivering strong financial performance. I'll start with an update on our global commercial performance and how our focus on customer engagement supports the increase in adoption and utilization of diagnostics.

IDEXX commercial teams are highly engaged in a customer-centric model that supports both existing customers' use of diagnostics and expanding our customer base. Our commercial professionals delivered another excellent quarter of results in Q3. Solid CAG Diagnostics recurring revenue reflects benefits from our expanding loyal installed base — and our veterinary partnership model to communicate the importance of diagnostics to clinicians. It also reflects benefits from our focus on placing high value analyzers at existing and competitive accounts in order to drive profitable future recurring revenues — including 5% competitive Catalyst placement growth in North America which supported solid EVI growth. Our continued progress on this front reflects a relentless focus on providing busy clinicians with the products, services, and the support they need to serve the high demand for veterinary services and meet the expectations of pet owners who seek — and increasingly demand — no compromises in the care for their pets.

In addition to driving the core growth in medical services in the clinic, diagnostics are also a key profit center. Continued growth in both diagnostics frequency and utilization per clinical visit was supported by gains in wellness testing per visit, building on substantial increases through the pandemic. This demonstrates that veterinarians continue to incorporate and expand the use of diagnostics in their care protocols while pet owners continue to show willingness to spend on their pets. This focus supported solid 7% gains in same-store diagnostic revenue gain at the practice level — growth that is being achieved despite ongoing headwinds in clinical visit growth in a resource constrained and challenging macro environment. This performance shows that pet owners continue to prioritize healthcare for their pets, which reinforces the resiliency of our sector.

And IDEXX customers are growing even faster — supported by our direct customer engagement model and superior, integrated diagnostic solutions. IDEXX's experienced sales professionals' deep partnership with the veterinarians they serve supported sector diagnostic revenue growth that outpaced both practice revenue and clinical revenue growth by 200+ basis points in Q3 — building on our strong momentum in helping to advance pet healthcare through diagnostics testing.

Growing our commercial footprint in a disciplined way is a key element of our customer engagement strategy. As we recently shared at Investor Day, extensive practice data analysis shows that customers using our broader diagnostics offering generate ~200 basis points higher practice clinical and diagnostics revenue growth — consistent with our execution trends. This benefits the patient, practice economics and, by extension, IDEXX. Our U.S. commercial expansion is progressing to plan, and we expect to enter the new year with the expanded team in place. This is the first U.S. expansion in 4 years, and many territories have appreciably increased in size since then. Increasing reach and engagement with clinics in our largest and most developed region prepares us well to support the growing portfolio of IDEXX innovations.

Outside of the U.S., we remain focused on deploying our commercial playbook in countries across the world and are encouraged to report that third quarter International CAG Diagnostics recurring revenues benefited from another quarter of improving volume growth. Higher reach-to-revenue metrics strengthen relationships between IDEXX commercial professionals and in-region veterinarians. Our increased commercial presence as a result of 7 international commercial expansions since 2020 helped drive solid double-digit year-over-year gains in our international premium instrument installed base across platforms. This includes record third quarter instrument placements in the Asia-Pacific region which helped drive 13% growth in our international installed base. This growth demonstrates that our highly capable sales teams have the right products at the right time and reinforces significant potential associated with the development of international regions. These geographies represent an outsized portion of our long-term opportunity of over 200,000 incremental premium placements for existing instrument categories.

Turning to our innovation agenda, software is a key pillar in our growth strategy and an area of important focus in the clinic – a trend that we are well positioned to facilitate and enable. Clinics are embracing software to improve efficiency in all aspects of their business, from patient processing and billing to diagnostics interpretation and pet owner communication. Higher software adoption is driven by the desire to realize the benefits of modern technology and applications to address these significant workflow pain points. It also positions practices to incorporate solutions that increase engagement with pet owners through scheduling and other tools that they use and rely on in other aspects of their lives. The multiplier benefit to our business from the adoption of IDEXX software is significant, reflected in third quarter growth in our software and diagnostic imaging segment — with high-teen organic gains in our highly profitable recurring annuity stream.

Excellent commercial execution — and strong customer interest — drove outstanding third quarter PIMS placements. Most notably our cloud-based PIMS products represented 95% of total PIMS placements and as a result now comprise over 50% of our PIMS installed base. This achievement reflects broad-based adoption of cloud-based products that reflects an inflection point in technology adoption. While veterinarians earlier in their careers are more digitally native, sales profiles indicate that customers of all career stages appreciate the workflow benefits and ease-of-use of our wide-ranging software stack. The common denominator is that contemporary software solutions allow them to better focus on the delivery of care and minimize non-value add administrative activities. Our software product offering also includes an integrated diagnostics portal, VetConnect PLUS™ with IDEXX DecisionIQ™, that not only provides testing results but also decision support, clinical insights, and next step considerations across a growing range of clinical use cases. IDEXX software and data solutions situate us well to benefit from these trends, as well as the accretion in operating margin drop through associated with a revenue base that is increasingly recurring in nature.

Our software innovation is deeply integrated with our diagnostics innovation approach — as evidenced by our highly successful instrument platform strategy, enabled by cloud-based capabilities and connectivity that enhance practice insight and workflow. We're very excited about our continued progress in bringing transformative solutions to point of care — and we are on plan to announce our new platform at VMX in January. Our product development efforts continue to advance aligned to our timing expectations and we are excited to share more details in just a few short months — and how it will add to our over 200,000 placement opportunity estimate for existing instrument categories.

We also continue to advance our innovation engine in other areas like advanced test menu. Innovation in assays that provide new clinical insights earlier in disease states is especially valued by veterinarians, since they drive higher standards of care aligned with the goal of improving health outcomes for their patients. Earlier this year, we announced the launch of an important new testing assay, Cystatin B, that expands our industry leading renal portfolio and will be available in early December beginning with our North American lab network. This will be followed by international launches over the course of 2024. This novel marker uses IDEXX IP to help clinicians detect kidney injury earlier and more definitively and is receiving broad support from key opinion leaders. Notably, a recent article in the Journal of Internal Veterinary

Medicine, co-authored by multiple International Renal Interest Society members, highlights the beneficial insights in distinguishing progressive from stable kidney disease by detecting active injury. These clinical insights represent important medical contributions and the test will be included in close to 2 million urine panels run at IDEXX reference labs in our first year post launch. Looking forward, we will announce an additional expansion to our reference lab testing menu in Q1.

In addition to these examples of product and service innovation – we continue to advance differentiated service delivery as a key element of our expansion strategy. We made a notable advancement in this area early in the third quarter when we opened our newest reference laboratory in Perth, Western Australia. Perth is an economically vibrant city that is a five-and-a-half-hour flight from our Brisbane laboratory – including a two-hour time difference – making it particularly difficult to service in the past. The addition of this new lab to our global network ensures customers will receive faster turnaround times for test results, enabling them to make timely and informed decisions for their patients' well-being. IDEXX provides the only veterinary-dedicated and accredited reference laboratory network in Australia and New Zealand, so bringing this location online is an important achievement as we strive to deliver sustainable long-term value. Expansion of our global reference lab footprint is just one way we are addressing the approximately two-thirds of our estimated TAM opportunity outside of the U.S., an area of focus.

With that, I'll now conclude the prepared remarks portion of the call. Before we move to Q&A, I want to take a moment to express our heartfelt sympathy for everyone affected by the events in Lewiston, Maine last week. We are deeply saddened by the senseless act of violence impacting our communities. Keeping our colleagues safe, supporting each other, and providing health and well-being support is a top priority during this difficult time. I also want to thank law enforcement and public safety personnel who are working tirelessly to keep our communities safe, and medical teams who continue to aid all who have been impacted.

Now, let’s open the line for Q&A.