



IDEXX Laboratories, Inc.

Q1 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](http://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 first 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 first quarter earnings call.

IDEXX had a solid start to 2023. In terms of highlights for the quarter:

- Overall revenues increased 10% organically – supported by nearly 12% organic growth in CAG Diagnostics recurring revenues.
- CAG Diagnostics recurring revenue gains were driven by nearly 14% organic growth in the U.S. – supported by solid volume gains and benefits from higher net price realization.
- Key execution metrics remained strong globally – reflected in record first quarter premium instrument placements, continued solid new business gains and sustained high growth in recurring veterinary software revenues.
- Operating profits and EPS increased 18% on a comparable basis – reflecting solid organic revenue growth, better than expected gross margin gains and benefits from a \$16 million customer contract resolution payment.

These strong results reflect the durability and resiliency of the IDEXX business model – and benefits from our ongoing focus on execution. We've incorporated our Q1 results in positive adjustments to our full year financial outlook – which we'll discuss later in my comments. Let's begin with a review of our first quarter results.

First quarter organic revenue growth of 10% was driven by 11% CAG gains and solid 8% growth in Water. Overall organic revenue gains were moderated by 2% declines in our LPD business and ~\$4 million of revenue headwind related to lower human Covid testing revenues, a business area that we winded down completely in Q1.

CAG Diagnostics recurring revenue increased 12% organically – reflecting 14% gains in the U.S. and 8% growth in International regions. CAG Diagnostics recurring revenue growth was supported by global net price gains in the 8%-9% range, consistent with our expectations.

Overall organic revenue gains were also supported by 14% organic growth in Veterinary Software and Diagnostic Imaging revenues. CAG instrument revenues were down 7%

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., we achieved a 1350 basis point growth premium compared to relatively flat same-store U.S. clinical visit growth levels in Q1. These results reflect benefits from execution drivers – including higher net price realization. Solid U.S. volume growth was supported by new business gains, high customer retention levels and continued increases in diagnostics frequency and utilization at the practice level.

International CAG Diagnostics recurring revenue gains were also supported by strong IDEXX execution, reflected in higher net price realization, sustained new business gains and a double-digit expansion of our premium instrument installed base. Double-digit growth rate benefits from these drivers were moderated by impacts from challenging international macro conditions – which continued to pressure same store volume growth trends in the quarter.

Globally – IDEXX achieved strong organic revenue growth across our modalities in Q1. IDEXX VetLab<sup>®</sup> consumables revenues increased 12% 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 double-digit increases across our Catalyst, Premium Hematology and SediVue<sup>®</sup> platforms. We placed 4,425 CAG premium instruments in Q1 – an increase of 3% year-on-year compared to very strong prior year levels – building on the record placement levels achieved in the fourth quarter of 2022. The quality of instrument placements continues to be excellent – reflected in 7% growth in new and competitive Catalyst placements. ProCyte One<sup>®</sup> momentum also continues to be strong globally – reflecting in a global installed base that more than doubled over the last year to 9,400 units.

Global rapid assay revenues expanded 12% organically – driven by strong growth in the U.S., reflecting solid volume gains and benefits from higher net price realization. Global lab revenues increased 11% organically – reflecting strong gains in the U.S. and mid-single digit growth in International, with growth in key international regions moderated by macro-economic impacts which have pressured same store sales. In terms of other areas of our CAG business – Veterinary Software and Diagnostic Imaging revenues increased 14% organically. Results were supported by continued high levels of organic growth in recurring software and digital imaging revenues – and ongoing momentum in cloud-based software placements.

Water revenues increased 8% organically in Q1 – reflecting solid gains in the U.S., Europe and Latin America, including benefits from net price improvement. The integration and performance of our recent Tecta-PDS acquisition has progressed well – expanding our capabilities in Water safety testing.

Livestock, Poultry and Dairy revenue decreased 2% organically – as solid gains in the U.S. and Europe were offset by comparisons to high prior year sales levels in herd health screening and reduced revenues from non-core food and safety products in certain regions.

Turning to the P&L – Q1 profit results were supported by a 150-basis point improvement in reported operating margins – reflecting 10% organic revenue growth, solid gross profit gains and benefits from a \$16 million customer contract resolution payment.

Gross profit increased 9% in the quarter as reported and 12% on a comparable basis. Gross margins were 60.3% – up 120 basis points on a comparable basis. Benefits from higher net price realization, lab productivity initiatives, improvement in software service gross margins and business mix offset inflationary cost effects. Later timing of lab

staffing increases and select operational upsides also supported Q1 gross profit results. As expected, reported gross margin gains were moderated by a 50-basis point negative impact related to foreign exchange changes, including the lapping of prior year hedge gains.

Operating expenses increased 5% year-on-year as reported in the quarter and 7% on a comparable basis. This was net of a \$16 million – or 6% operating expense growth offset – related to the customer contract resolution payment. As planned, we saw higher growth in sales & marketing and R&D expense in the quarter related to specific factors including the return of in-person sales meetings this year and advancement of key innovation initiatives.

EPS was \$2.55 per share in Q1, an increase of 12% as reported and 18% on a comparable basis. Foreign exchange reduced operating profits by \$12 million and EPS by \$0.11 per share in the quarter, including impacts from the lapping of prior year hedge gains.

Free cash flow was \$144 million in the first quarter. On a trailing 12-month basis, our net income to FCF conversion ratio was 65%. For the full year, we're maintaining our outlook for FCF conversion of 80%-90%, including estimated capital spending of ~\$180 million.

Our balance sheet remains in a strong position. We ended the quarter with leverage ratios of 1.1x gross and 1.0x net of cash – down modestly from Q4 levels. Share repurchases over the last year supported a 1.9% reduction in diluted shares outstanding. We didn't allocate capital to share repurchases in the first quarter, as we manage our balance sheet relatively more conservatively in the current interest rate environment.

Turning to our 2023 P&L outlook – we're refining our FY outlook to incorporate our solid Q1 operating results and updated estimates for foreign exchange impacts.

We're updating our FY guidance for reported revenues to \$3,615 million - \$3,700 million, this includes a \$10 million positive adjustment for foreign exchange impacts, which we now estimate will provide a relatively modest FY headwind to reported revenue growth.

Our updated outlook for overall organic revenue growth is 7.5% to 10%. Our Q1 results tracked towards the high end of this range and we're maintaining consistent high-end targets for our performance this year, reflecting benefits from execution drivers and the potential for reduced clinical visit growth headwinds. As part of our financial management approach – we incorporated risk estimates to our targeted growth performance in the low end of our organic revenue growth range, including potential effects from macro-economic conditions. We raised the low end of our full year organic revenue growth outlook by 0.5% in our updated guidance, incorporating our solid start to the year.

We're maintaining our outlook for solid operating margin performance in 2023 – with an expectation for reported operating margins in the range of 29.0% - 29.5% for the full year. At the high end, this reflects an outlook for ~340 basis points in comparable operating margin expansion. This includes ~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. We now estimate that foreign exchange will reduce reported operating margins by ~60 basis points this year – slightly higher than earlier projections – which included impacts from the lapping of \$26 million in 2022 hedge gains.

Our updated EPS outlook is \$9.33 to \$9.75 per share, reflecting a \$0.06 per share increase in our low-end estimate. We continue to estimate that foreign exchange

impacts will decrease EPS by ~\$0.23 for the full year – with the bulk of this impact in the first half.

In terms of our operational outlook for Q2 – we're planning for overall organic revenue growth consistent with the midpoint to higher end of our full year growth outlook range – with ~1% of reported growth headwind from year-on-year FX changes. In terms of Q2 operating margins – we're planning for reported operating margins in the range of 29.0% to 29.5%. This reflects expectations for relatively consistent operating margin performance year-on-year adjusting for ~70 basis points in negative foreign exchange impacts and benefits from comparisons to prior year results which included \$80 million in discrete R&D investment.

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

Overall, we're applying a disciplined financial approach that advances our growth strategy – and mitigates potential macro risks – to ensure delivery of continued strong financial performance.

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.

I'm pleased to share that IDEXX had a very strong start to 2023, driven by sustained execution of our growth strategy. Demand for companion animal medical services continues to grow, supported by IDEXX innovation and direct customer engagement. Veterinarians continue to focus on meeting these high levels of demand with the best possible medical care, with diagnostics as an essential component of this care

equation. IDEXX remains a chosen, trusted partner to veterinarians who appreciate how our world-class products and connected ecosystem enable high standards of care while resulting in growth of a significant profit center within their clinics.

IDEXX's strong execution is reflected in double-digit total company organic revenue growth, supported by strong expansion of global CAG Diagnostics recurring revenues. Growth in this recurring revenue annuity was supported by solid contribution from new business gains, sustained high customer retention rates, and net price realization aligned with our expectations. Our commercial teams drove another record quarter for global premium instrument placements and excellent levels of cloud-based software placements. IDEXX products and services offer solutions to improve clinic productivity and support the significantly expanded and underserved demand we've seen for pet healthcare in recent years including net pet additions in the U.S. of 2% in 2022, twice the pre-pandemic trend line. These efforts supported strong IDEXX growth as we continue to work effectively through the near-term sector headwinds related to clinic capacity constraints and global macro conditions.

Today I'll discuss how IDEXX's sustained execution against our strategy to drive the adoption and utilization of diagnostics helped deliver continued strong financial results. First, I'll provide an update on our commercial execution, which through education and customer engagement, drives relevant utilization of IDEXX's innovative solutions.

IDEXX commercial teams delivered another record first quarter global premium instrument placements to start 2023, building on very strong prior year results. Our commercial teams demonstrated a continued ability to advance placement quantity and quality. This is reflected in strong growth in Catalyst placements at new and competitive accounts globally driving solid EVI achievement. These commercial results are highly encouraging as we address the significant opportunity for an estimated 220,000 worldwide premium instrument placements – and give us confidence that we have the right strategic playbook in place. IDEXX professionals provide world-class,



software-enabled products that are in high demand, and supported by a wide menu of customer-friendly marketing programs that enable adoption of new technology. These results also reflect continued strong clinical interest in using IDEXX's products and services, to not only meet the increased demand for pet healthcare, but to deliver the best possible level of care.

Our commercial execution is supported by the "multiplier" benefits that flow from IDEXX innovations – as evidenced by the success of our newest hematology analyzer, ProCyte One®. ProCyte One® provides customers with an attractive in-clinic hematology solution – its small footprint, easy pay-per-run model, and lower cost come without sacrificing CBC performance. IDEXX premium placements have benefited from strong ProCyte One® adoption to date thanks to sustained high attach rates with Catalyst, as defined by ProCyte One® placements either with a Catalyst or at an existing Catalyst customer. The result is a multiplier benefit, supported by clinics who choose to outfit their in-clinic suite with IDEXX products. As a result, we are nearly halfway to the incremental 20,000 premium hematology placement objective we shared at Investor Day following ProCyte One's® launch, while the strong attach rates should also help IDEXX penetrate the long-term worldwide placement opportunity.

Key to developing this long-term opportunity will be increasing customer engagement in international regions. We're leveraging our successful VDC model to build strong relationships with international customers, as evidenced by sustained strong new business gains and a 19% increase in Catalyst placements. This strong performance is allowing us to deliver solid CAG Diagnostics recurring revenue growth in international regions despite continued macro headwinds which have pressured same store clinical visit levels.

Customer engagement remains excellent as evidenced by high reach-to-revenue levels in the first quarter – including benefits from our expanded commercial sales force in targeted regions. The flywheel is beginning to turn in these countries, where we've seen

excellent gains from new business, strong interest in engaging with customer marketing programs, and solid overall volume growth. Commercial expansion is an important early step in our international strategy, supporting recent efforts to optimize our reference lab network, roll out highly relevant products like ProCyte One, and drive further adoption of software tools like VetConnect® PLUS, our cloud-based diagnostic portal.

Software innovation continues to be a key driver of our growth strategy globally. IDEXX software solutions are a key enabler of diagnostics utilization -- creating a connected ecosystem that helps improve diagnostics workflow while providing deeper clinical insights and supporting pet-owner communication. It's an attractive standalone business as well. Strong PIMS placements in the first quarter were supported by continued preference for cloud-native products, with IDEXX well-positioned to address this trend. Placements of cloud-based products maintained the strong velocity we saw coming out of 2022 and represented >90% of total placements – supported by continued high interest in our ezyVet® and Neo® solutions which are seamlessly integrated into our product offering. This provides customers with options when it comes to picking the best, most relevant PIMS solution for their clinic size and workflow complexity. Our strong first quarter placement performance supported double-digit recurring revenue growth with an attractive gross margin profile – and we're on track to achieve this year a PIMS footprint that is over 50% cloud-based. This milestone is especially important in the current veterinary clinic environment, where productivity is a priority in addressing the sustained high levels of demand seen through the pandemic.

By embracing IDEXX's cloud-based ecosystem, customers gain the advantage of an easy-to-use software stack that touches every area of the veterinary clinic. And the benefit of these tools is enduring for our customers, evidenced by strong engagement metrics across applications – including increasing rates of our Web PACs™ user base that are Power Users as well as sustained rates of VetConnect® PLUS users who use the software as part of their daily routine. Adoption and continued use of these

products allows veterinarians and their staffs to spend more time focusing on the care they deliver to their patients rather than on costly, time-intensive administrative activities. Our software strategy is to increase cloud-adoption and build increased business and clinical functionality into IDEXX software solutions.

Another use-case of our innovation agenda is our 4Dx<sup>®</sup> Plus test – the gold standard test for canine vector borne disease testing. The current 4Dx<sup>®</sup> Plus test is our fourth version of a multiplexed canine vector borne disease diagnostic over the past 20+ years with improved sensitivity of Anaplasma and a two-times increase in the ability to store the product at room temperature. This is a true testament to our Technology for Life strategy – and supported 12% global organic Rapid Assay recurring revenue growth and solid customer gains in the first quarter. A full vector borne screen using 4Dx<sup>®</sup> Plus is recommended over a Heartworm-only test given significant increases in incidence and prevalence of vector borne diseases over the past 10+ years. And yet, in 2022 less than 1 in every 5 dogs received this comprehensive level of testing. 4Dx Plus enables veterinarians to deliver this higher standard of care, with follow-up testing and care protocol guidance provided through DecisionIQ<sup>™</sup> which aim to drive better health outcomes while encouraging increased diagnostic testing. Furthermore, our entire Rapid Assay franchise is supported by the SNAP Pro analyzer. The analyzer not only simplifies the workflow when running a SNAP test but also ensures the diagnostic results flow seamlessly to VetConnect<sup>®</sup> PLUS and ultimately result in charge capture and invoicing at the point of sale. This is a clear case of how our products, integral components of our connected software ecosystem, improve in value over time while delivering a multiplier benefit to our customers and drive IDEXX CAG Diagnostics recurring revenue.

The sustained execution against our commercial and innovation agendas is made possible by an unrelenting focus on our customers and ensuring they have a world-class experience with IDEXX. This takes multiple forms, all focused to ensure our customers have the resources they need to provide the best possible levels of medical

care. Continued 99%+ product availability and reliable, fast reference lab service turnaround times provide them with important business continuity and are the result of our investment in manufacturing and supply chain logistics teams, facilities, and relationships. Additionally, the support of the high-touch, highly knowledgeable sales teams that we have built out over decades ensures they have the products and services that are right for their busy clinics. Our customers realize the benefits of the IDEXX partnership every day, and in turn reward us with their business and their enduring loyalty, as measured by another quarter of consistent, high customer retention rates.

Providing our customers with reliable, consistent support is even more essential right now given the dynamic backdrop of our sector. High demand for animal medical services combined with sustained labor supply constraints continue to create productivity and growth challenges at the clinic level. Taking our customer support efforts a step further, we recently published an empirically based study, which examines the drivers of productivity within a practice and helps customers to understand their productivity strengths and areas for opportunities. Through this rigorous effort we found three key drivers of practice productivity:

1. Workflow: which includes staffing models like optimized technician to veterinarian mix, and staff and patient friendly physical layout of the practice.
2. Technology: or digitizing each step of the patient workflow to remove high-effort administrative routines.
3. The role of culture: including clarity of roles and responsibilities, investments in training and staff effectiveness, and aligned incentives to drive teamwork and achievement of practice goals.

As a result of this initiative, we believe there is still a great opportunity for clinics to improve productivity measures and we look forward to educating and supporting our customers in these efforts. Opportunities to do so could result in 30% or more incremental visit capacity, even for practices that are in the top cohort of productivity.

We are integrating elements of these efforts into our strategy and commercial approach this year.

With that, I'll now conclude the prepared remarks portion of the call by thanking our nearly 11,000 IDEXX colleagues for the commitment and passion they bring to our purpose-driven work every day. Your efforts not only help provide a better future for animals, people, and our planet, but you also supported IDEXX in starting 2023 on a strong financial note. We have an attractive sector and a strong track record, and the opportunity ahead of us which is significant is to work with our customers to elevate companion animal healthcare standards through increased diagnostics utilization. The tireless work of the IDEXX team has positioned us well to deliver solid growth and financial results into the future. So, on behalf of the management team, thank you for your continued focus on enhancing the health and well-being of pets, people, and livestock.

Now, let's open the line for Q&A.