Q2 2021 Heska Corp Earnings Call

Tuesday, 08/03/21 11:00 AM - HSKA-USQ

Final Transcript

Heska Corp - HSKA.OQ - Earning Conference Call/Presentation

Corporate Participants

- Catherine I. Grassman - Heska Corporation – Executive VP & CFO
- Jon Aagaard - Heska Corporation – VP, Head of IR
- Kevin S. Wilson - Heska Corporation – CEO & President

Conference Call Participants

- Elliot Henry Wilbur - Raymond James & Associates, Inc., Research Division - Senior Research Analyst
- James Philip Sidoti - Sidoti & Company, LLC - Research Analyst
- Benjamin Charles Haynor - Alliance Global Partners, Research Division - Analyst
- David Michael Westenberg - Guggenheim Securities, LLC, Research Division - Research Analyst
- Poon Mah - Piper Sandler & Co., Research Division - Director & Senior Research Analyst
- Christopher Thomas Schott - JPMorgan Chase & Co, Research Division - Senior Analyst

Presentation

- **Operator - -**

  Good day, and welcome to the Heska Corporation Second Quarter 2021 Earnings Call. Today's conference is being recorded.

  At this time, I would like to turn the conference over to Jon Aagaard, Vice President, Investor Relations. Please go ahead, sir.

- **Jon Aagaard - Heska Corporation - Head of IR**

  Thank you, and good morning, everyone. Welcome to Heska Corporation's earnings call for the second quarter of 2021. As a reminder, today's conference is being recorded. I'm Jon Aagaard, Head of Investor Relations at Heska. And with us this morning, we have Kevin Wilson, Heska's Chief Executive Officer and President; and Catherine Grassman, Heska's Chief Financial Officer. Mr. Wilson and Ms. Grassman will provide details surrounding the results reported, and then we will open the call to questions.

  Prior to discussing Heska's results, and before I turn the call over to Kevin, I would like to remind you that during the course of this call, we may make certain forward-looking statements regarding future events or future financial performance of the company. We need to caution you that any such forward-looking statements are based on our current beliefs and expectations and involve known and unknown risks and uncertainties, which may cause actual results and performance to be materially different from that expressed or implied by those forward-looking statements.

Factors that could cause or contribute to such differences are detailed in writing in this morning's earnings release, Heska Corporation's annual and quarterly filings with the SEC and elsewhere. Any forward-looking statements speak only as of the time they are made, and Heska does not intend and specifically disclaims any obligation or intention to update any forward-looking statements to reflect events that occur after the time such statement was made. To encourage broad participation in the question-and-answer session this morning, we ask each participant to exercise discretion with a number of questions and to follow up as time permits.

With that being said, it is now my pleasure to turn the call over to Kevin Wilson, Heska's CEO and President. Kevin?

- **Kevin S. Wilson - Heska Corporation – President & CEO**

Thanks, Jon, and good morning to everybody. I know you've got a full day, and I appreciate that you're taking the time with us this morning. Just like last quarter's call, the SparkNotes version of Heska's quarter is simple today. Heska had a great second quarter, both year-over-year and sequentially. Our underlying markets are doing very well, and we believe this is sustainable. Performance specific to Heska is also doing very well, and we believe Heska is a great place to be for the remainder of 2021 and well beyond. I encourage listeners to fully review the results and the data published in this morning's release. I think, you'll find it helpful and informative, and I'll avoid as much as possible inefficiently reading it to you this morning.

Rather, with the remainder of the time this morning, Catherine and I will keep our prepared remarks brief to allow for more Q&A time to go a bit deeper into the areas that interest you. But before we get there, I would like to highlight a few points, some of which will echo our recent calls. Broadly, as I said, the overall market situation is great. Specific to Heska in the second quarter, the results are a strong follow-through in the first quarter with solid sequential and year-over-year performances to be found almost everywhere one looks. In our North American and International segments, I'll just say thank you to our teams, they're expert, and they work hard. In today's release, Catherine will detail their scoreboard. It was a great result and everyone at Heska should be proud of their accomplishments.

Specific to our International segment gross margins, our International products rationalization and upgrade cycle is well underway, and that is simultaneously accelerating our already rapid conversion to subscriptions and to greater future margin capture. Despite the low margin drag from accounting for a wonderful 80.7% growth in initial subscriptions lab equipment placements internationally, our teams in Germany, France, Italy and Spain are moving so fast and doing so well with our programs that year-over-year International gross margins have improved 170 basis points as installed customers use higher gross margin consumables. When we acquired these International assets in early 2020, we believe there was substantial opportunity to bridge their margins close to the North America margins, and we're well on our way to doing so.

In our operations, I was again pleased to see that when Heska sells more of the right mix, we see operating leverage. I guess I'll just leave it at that this morning. We intend to do more of that while managing our business well. Operationally, the team did a great job. In our R&D launches, we're moving at warp speed. Our many announced analyzers, test menu, and new services expansions continue their launches in rapid fire succession, and we continue to see strong demand for what we're launching. There are so many projects launching. I encourage investors to review our latest Investor Presentation for more information.

Our most highly anticipated project launch for 2021 is for Element AIM, our transformative artificial intelligence microscopy platform aimed at revolutionizing urine and fecal testing at the Point of Care. Element AIM continues to make solid progress for manufacturing at scale and for installation of general release to our anxiously awaiting subscribers on schedule in the fourth quarter. With a very limited number of pre-release Element AIM units on hand and in hospitals today, early indications are positive and appropriate for our time line. While we did experience some supply chain disruption and delays for things like advanced computer chips and displays and general freight delays, which moved out our installation volume ramp. These things are accounted for in our updated 2021 outlook, and we remain quite optimistic for a very successful reception at volume, and we continue to anticipate meaningful financial contribution for Element AIM in 2022 and beyond.

In our dry chemistry line, at the end of June, our team surprised the market with a major and unexpected launch of an all-new element in DCX. Years in the making, Element DCX occupies the sweet spot between our economical Element DC and our ultra-high capacity Element DC5X. Our sales teams are thrilled, our current subscribers are emboldened to extend their subscriptions and expand their utilization commitments, and we believe new customers will be similarly motivated by Element DCX to make the switch to Heska.

Moving on to our resources, our capital structure is well prepared to play offense. We have the capital, we have the domain expertise, and we have identified specific opportunities to properly put it to work. In the second quarter, we began by taking our initial step into the international reference laboratory space by acquiring Milan-based BiEsseA, which since 1978, has been one of Italy's leading veterinary central reference laboratories. We intend to knit together the BiEsseA, central laboratory and our trusted local skilled Point of Care diagnostics teams and products to offer the best bundle in diagnostic subscriptions available to veterinarians in Italy. While the 2021 financial contribution of BiEsseA will be quite modest, this first effort in Italy will serve as an important model for launching, optimizing and scaling bundled offerings in our key international markets.

To summarize, we finished our 2 labs of 4 labs in 2021 very strongly, and are now confidently raising our outlook for 2021. We are a whirlwind of positive activity, results and opportunity. The first half of 2021 has been fun. I think the rest of 2021 and all of 2022 will be fun. I could talk for hours about how and why, but as I promised at the beginning of the call, I'm not going to do that. And I'm going to turn the call over to Catherine to detail the quarter before we move into Q&A.

Catherine?

- **Catherine I. Grassman - Heska Corporation - Executive VP & CFO**

Thanks, Kevin, and good morning, everyone. As Kevin mentioned, Heska's second quarter results continued the strong performance experienced in the first quarter of this year, and we are tracking ahead of our full year 2021 outlook communicated in February.

We reported total revenue of $64.9 million, a record quarterly performance. Execution on our strategic growth initiatives and continued positive industry trends contributed to our exceptional results in the second quarter. Our North America segment revenue grew 39.9% in the period. Driving this achievement was record consumable revenue of $19.3 million, growth of 42.5%. The growth is attributed mainly to increased utilization among existing and new customers as well as pricing. We also experienced growth of more than 70% in Point of Care Imaging as capital placements appear to have recovered from a more severely COVID-impacted comparative. Our International segment reported approximately 46% growth in revenue for the second quarter of 2021, a 26% growth in consumable sales and the recovery of capital placements contributed to this performance.

Consolidated gross margin expanded approximately 290 basis points to 42% in the period. The North America segment delivered gross margin of 47.9% in the second quarter of 2021 compared to 44% in the second quarter of 2020. Increased consumable sales and POC lab and increased plant utilization in OVP contributed to this expansion. The International segment gross margin was 32.2% for the second quarter of 2021, compared to 30.5% in the second quarter of 2020. Execution on previously communicated cost synergies drove this expansion. The strong performance in 2021 has led to an increase in compensation-related costs, which is the primary driver of increased operating expenses of approximately 25% in the second quarter of 2021.

Adjusted EBITDA margin for the second quarter of 2021 was 13%, greater revenue, favorable sales mix and leveraged operating costs resulted in a 390-basis-point improvement compared to the prior year. EPS in the second quarter was a loss of $0.06 per share. Non-GAAP EPS was $0.50 per share, an increase of $0.50 per share from the second quarter of 2020. We continue to maintain a strong liquidity position with cash of $245 million, supported by our successful capital raise during the first quarter and further strengthened by free cash flow generation during the first half of the year.

As a result of our strong performance, we are raising our annual guidance as follows. Consolidated revenue range of $250 million to $260 million, effectively representing year 2 of our previously provided outlook as part of our Investor Day presentation in November of 2020, which results in growth of approximately 27% to 32% as compared to 2020. Global

POC lab revenue to be $150 million to $160 million, growth of approximately 33% to 42% as compared to 2020. Driving our increase in POC lab revenue is our North America consumable growth rate, which is now expected to be greater than 20%. As a result, we expect adjusted EBITDA margin to be greater than 10%, an improvement of 200 basis points from our previous guidance.

With that, we would like to open the call for your questions. Operator?

Question And Answers

- **Operator - -**

  A. Thank you. (Operator Instructions). And we will take our first question from Chris Schott with J.P. Morgan.

- **Christopher Thomas Schott - JPMorgan Chase & Co, Research Division - Senior Analyst**

  Q. Great. Thank you so much and congrats on all the progress this year. I just have two questions. The first was just can you elaborate a little bit more on your expectations for that volumes as we progress through the remainder of 2021. I guess, do you expect to see any sequential slowing or any changes of note as I guess, reopening continues and people are maybe away from their pets a bit more? And my second question was on gross margins. You've had great performance year-to-date. I was just wondering if the roughly 42% gross margins we've seen this year of the first half is a decent baseline to think about going forward given the strong pull-through you're seeing? Or is it something unique about mix in the first half that we should think about normalizing in the second half of the year? So I'm just trying to get a sense of just, how sustainable those margins are and just how to think about growing those going forward?

- **Kevin S. Wilson - Heska Corporation -**

  A. Yes, you're welcome. So I'll address really quickly, because I don't know if there's a ton of data to be shared on the veterinary volumes. We think they're sustainable. I don't think there's necessarily a spike or a pent-up. It's been many, many quarters now. So people keep looking for a spring back or a drop or I think they're sustainable. There's a narrative out there that people are tired. Obviously, you have labor shortage issues and things like that. Inflation is a macro theme. Everybody is probably appropriately worried about such things in the economy in general. But our business is up substantially, and we work hard and we're tired, and all my friends are veterinarians, their business is up and they work hard and they're tired, but they're doing a great business and they care about their business, and we don't see that really as a major constraint. So we think the volumes are sustainable. There was a step-up last year, we've talked about on the last call or two, and we think that step-up is real and sustainable. And so, I'll let Catherine speak to the gross margin question.

- **Catherine I. Grassman - Heska Corporation - Executive VP & CFO**

  A. Yes. So in the second half of the year, we have, I would say, on a full year basis, when we look at the quarter-to-date and year-to-date at 42%, I think it will come down a bit in the back half, maybe about 100 basis points for a full year ending around 41%, providing the launch of Element AIM and other type mix involved in on back half revenue mix.

- **Operator - -**

  A. Our next question comes from David Westenberg with Guggenheim Securities

- **David Michael Westenberg - Guggenheim Securities, LLC, Research Division - Research Analyst**

  Q. Thank you for taking the question. I reiterate the congrats on the great quarter. I'm going to actually follow up with the previous question on kind of on the macro theme. Can you maybe just talk about that supplying the demand that's out there from consumers or veterinarians ability to? And I just want to talk about a little bit more in like how we should think about competitive physician as a company that relies on inside lab diagnostics versus send out the reference lab model. If there is sort to say a labor crunch, should we worry about maybe a move towards reference lab from labor-constrained veterinarians? And I'll stop there before asking the next question.

- **Kevin S. Wilson - Heska Corporation -**

  A. Yes. So I understand the theory. We're not worried about it. We've been in the Point of Care business for a long time and the reference lab business has been around for a long time, and we don't see massive shifts in one direction or the other for really quite a long time. So I understand the theme. We're not seeing it. You see it anecdotally, but we don't think there's going to be an enormous labor crunch that's going to cause behavior and clinics to change on a mass scale. It's really the same thing. You could argue that it's much more efficient to use a Point of Care test and finish your conversation with a pet owner rather than chasing them down with text and follow-up phone calls at the end of the day. The same dynamics for Point of Care and reference lab, I think, are still in play, and I don't think there's a labor crunch showing up in the numbers. So I think I answered the question. That's our take on it. And it's not the first time that it's come to the idea that maybe there aren't enough veterinarians to serve millions of pets. It's actually one of the things that's unique about our space, and I think has driven growth and has driven innovation. So the more that we can do to make the veterinarian more efficient, the better, the more the veterinarian can jettison non-core activities, less profitable activities and less defensible activities, the more we think they'll migrate to things like diagnostics. So we like it. We like the macro setup. We think it's good.

- **David Michael Westenberg - Guggenheim Securities, LLC, Research Division - Research Analyst**

Q. Okay. I'm going to move on to kind of the next theme, and that would be on implied guidance. You brought up guidance in overall revenue. And then you gave a range for kind of the blood diagnostic contribution. I think, it implied a little bit that OVP would be also kind of going up. Is that the correct way to think about it, because I mean, they're all ranges so you could kind of play say anything. Is there an implied increase in OVP? And if is, that is consequently an implied OVP increase in guidance, can you talk about maybe the margin impact from that in the back half of the year? And I'll step back in queue after that. I don't want to take too many questions from everyone else.

- **Kevin S. Wilson - Heska Corporation -**

  A. Thanks David. Catherine, go ahead.

- **Catherine I. Grassman - Heska Corporation - Executive VP & CFO**

  A. No, it's a great question. I'll go ahead and take that. The implied is a slight uptick in Q3 into Q4, not as heavy as last year's Q4 for OVP. But mostly in line with last year's results for OVP. So we guide, I think, generally we in the past, guided $16 million to $17 million, that's about where we'll end the year. You're correct on the back half margin for OVP that will have a bit of a drag. So that's part of that decline in the second half.

- **Operator - -**

  A. (Operator Instructions) We will take our next question from Steven Mah with Piper Sandler.

- **Poon Mah - Piper Sandler & Co., Research Division - Director & Senior Research Analyst**

  Q. Thank you and congrats on the quarter. A follow-up question on the gross margin expansion. So it seems like the international subscription model conversion seems to be proceeding better than expected. Could you give us some more details on this conversion rate? And if you think it's going to continue on this pace going forward? And when do you expect the conversion to be complete?

- **Kevin S. Wilson - Heska Corporation -**

  A. In terms of completion, I still think we have a little while, like it's not going to be a quarter or two. But the rate is really exciting. So I had the opportunity to be in Europe a couple of times here in the last month with the teams in person. So international travel is possible and got a really encouraging update. So I'm thrilled when I see a little bit of a margin drag. It just means they're placing hundreds of subscriptions and converting them to long-term five, six, seven year subscriptions. And just the way it works, just if you use a simplified view of it, let's just say you put in hundreds at in 1 month. And what happens with the gross margin as you place the equipment. So let's just for illustration purposes called at a 30% gross margin. You only have 1 month of utilization of say, 60% consumables in that month. And so 1 month of utilization isn't going to swamp the capital equipment recognition. And what's thrilling about that is as that snowball gets bigger and bigger and bigger, you just have higher percentage of those customers installed using high gross margin consumables. So they were ahead of where I had hoped. So I think they're doing a great job. That was a long answer to say they're ahead of where I hoped and I think they're doing a great job.

- **Poon Mah - Piper Sandler & Co., Research Division - Director & Senior Research Analyst**

  Q. Okay. Great. Thanks. And next question, on the acquisition of by BiEsseA, I hope I'm pronouncing that right. Can you give us a sense of the scale of that business? And then also talk about the rationale for acquiring a reference lab. I'm more getting at does BiEsseA test menu not overlap with your Point of Care testing menu? How do you think about that?

- **Kevin S. Wilson - Heska Corporation -**

  A. So the rationale, we have a very good business based in the Milan, Italy area for Point of Care and rapids. And they have a very nice business and a great reputation for decades in the same location. And so the ability you could look at diagnostics and veterinary care as a two-handed opportunity. So on the one hand, you have reference lab, send-out opportunity, call that 50%. On the other hand, you have 50% that's happening Point of Care. And that's largely behavior-driven more than necessarily just overlapping menu. The reference lab has always had the menu that we have at the Point of Care. It's really more about getting an answer in 10 minutes instead of sending it out and using those logistics. But we only have a firm grasp of 50% of the opportunity in Point of Care. So putting together a reference lab with that, and then the ability to sell reference lab services to our Point of Care customers who don't use BiEsseA and the ability to sell point-of-care services to the BiEsseA central reference lab customers who don't use our Point of Care, and we share some customers in common. So it's really a very logical bundle. It's not unique. Our largest competitor has done it successfully here in the States primarily for a very long time, and we think there's a lot of blue water in these European markets to put local providers and local language with local culture with decades of reputation to put those together and put those into a bundle and capture both sides of the opportunity.

- **Poon Mah - Piper Sandler & Co., Research Division - Director & Senior Research Analyst**

  Q. Thanks. Makes sense. And can you comment on the gross margin of the reference lab space versus Point of Care? And how should we think about gross margins going forward?

- **Kevin S. Wilson - Heska Corporation -**

  A. They tend to be in line with our consumables, and perhaps maybe a little bit additive. It really depends on volume. So the reference lab businesses tend to be more fixed cost. And once you get above your incremental testing level to cover your fixed cost, your incremental gross margins are wonderful. So it's really about driving volume. And so we think we can probably drive volume with the bundling in this opportunity and others to grow reference lab gross margins as well. But you can think of them roughly in line with our consumables gross margin.

- **Operator - -**

  A. We will take our next question from Elliot Wilbur with Raymond James.

- **Elliot Henry Wilbur - Raymond James & Associates, Inc., Research Division - Senior Research Analyst**

  Q. Kevin, just maybe following up on your comments with respect to the reference lab. Could you give us a run rate on that business? Or maybe just talk about what you see as the incremental top-line potential at this point?

- **Kevin S. Wilson - Heska Corporation -**

  A. Yes. So we didn't call out a specific number, but very small, and I apologize, I wasn't ducking that question. I know I didn't answer something. I just couldn't remember what it was. So yes, you can look at that as very low single digit in terms of $1 million this year. So it's not really going to contribute very much in terms of revenue this year. Like not enough to model, I guess, is what I would say. So you could think about it maybe for the balance of the year is $1 million or $2 million. We're not going to call it specifically, but it's not consequential.

- **Elliot Henry Wilbur - Raymond James & Associates, Inc., Research Division - Senior Research Analyst**

  Q. All right. And then I guess with respect to the strong over-performance in the quarter, certainly much higher in North American consumables than International. Maybe just provide a little bit of color on some of your key drivers or what over-performed versus expectations in terms of utilization or just overall visit level price or testing mix, and maybe how some of those dynamics differ between North America and the International market?

- **Kevin S. Wilson - Heska Corporation -**

  A. Yes. So some of it is our business model is designed to be a little bit out of sync. So we've been focusing very aggressively on utilization, and utilization in our larger facilities specifically in North America. The international market, we're in a phase where we're really laser-focused on moving to a subscriber base, getting customers on five, six, and seven year subscription contracts. And so it's just really more of a difference in focus. We're not driving utilization programs in our International installed base. We're really, our conversations are surrounding the benefits of signing up with us for 6 years. So driving utilization isn't really the focus. I think, as we complete that over the next year or so, we'll start to drive utilization. Utilization in international markets also is just lower than it is in North America market. So we see that as an opportunity. So let's just say in the aggregate, the utilization per site is half what it is in North America. Just like the gross margin, we see that as an opportunity to bridge closer to North America utilization rates. But right now, our focus is really moving that entire market to a subscriber base as opposed to leaving them just on an individual purchase every month without the visibility of the commitment.

- **Elliot Henry Wilbur - Raymond James & Associates, Inc., Research Division - Senior Research Analyst**

  Q. And then just the last question, a quick one on the financials. Just given the relatively high level of stock comp in the quarter, maybe Kevin just comment on where that expense is allocated between selling and marketing and G&A, just thinking about expense trends for the second half of the year? And also your commentary regarding some deceleration in gross margin performance in the second half. Would you expect that to carry through at a similar level to EBITDA margin?

- **Catherine I. Grassman - Heska Corporation - Executive VP & CFO**

  A. Elliot, yes, those are both great questions. So first, taking stock-based comp as it pertains to where it shows up, primarily G&A, but there is some in selling and marketing, but majority sits in G&A, and we expect a similar trend in the second half of the year as it pertains to stock comp. As far as the back half that will flow through to adjusted EBITDA margin, coupled with increased operating expense in the second half relating to increased R&D from the first half as well as other G&A-type costs, short-term incentives and marketing and sales.

- **Operator - -**

  A. We will take our next question from Ben Haynor with Alliance Global Partners.

- **Benjamin Charles Haynor - Alliance Global Partners, Research Division - Analyst**

  Q. Thanks for taking the questions. First off for me, just thinking about the acquisition that you made in Italy, the reference lab, is there the possibility that you expand this model beyond Italy? Is there the possibility that you could take samples from other countries in Europe and run to the Italian lab, just kind of some of the strategic characteristics and what you can do with that lab and having the bundled platform?

- **Kevin S. Wilson - Heska Corporation -**

  A. Yeah, Ben, thanks for the question. Yes, we fully intend to service other countries. We have just great decades long nice market share installed bases in places like France and Germany and Spain and the Nordics, a lot of these countries. And so we think having that sales force and having that Point of Care installed base of thousands across those, those are very logical customers for reference lab offerings. So yes, we would look to replicate that model in those markets.

- **Benjamin Charles Haynor - Alliance Global Partners, Research Division - Analyst**

  Q. Potentially, would we ever see it here in North America as well, maybe signing up with a large private company to co-market or anything like that?

- **Kevin S. Wilson - Heska Corporation -**

  A. No, the North America market just has different dynamics and the cement is reasonably hardened. There are two large reference lab companies that split 95%, maybe even more of the market. So trying to disrupt the duopolies, that's a windmill I'm not all that interested in tilting against. We've got greater assets and more opportunity and the cement is not hardened in a lot of these European markets. So we think it's important that we'd be one of the winners, and one of the leaders in that space and bundling opportunities in these European markets. So we're going to focus there. We're small enough, but we still have to focus, and that's where we're going to focus.

- **Benjamin Charles Haynor - Alliance Global Partners, Research Division - Analyst**

  Q. That's fair enough. And then lastly for me, just with some of the dynamics on the practice level, you mentioned folks being tired. A lot of these practices have become more flush with cash than they have been in the, call it, last decade or more. Do you think that shifts at all the willingness to purchase capital equipment or get on to a rental model like yours or otherwise makes capital sales more attractive or less attractive? What's your sense of how practices are thinking about it? And then kind of where does the DCX fit into that?

- **Kevin S. Wilson - Heska Corporation -**

  A. So for Imaging, digital radiography in particular, I think it's really a sweet spot for a number of reasons. You still get accelerated depreciation opportunities. The large capital equipment investments and digital radiography would fit that bill in that, call it, $35,000 to $50,000 range. So I do think in the fourth quarter, as accountants -- remember, a lot of these are individually owned, they are LLCs with flow through income, their sole proprietors. They've done very well and they're going to have a tax problem. So I do think offsetting that with investment in capital equipment and a refresh cycle is favorable for capital equipment purchases. In relation to Element DCX, what's really nice about that is we have thousands of Element DCs around the world that we would love to offer faster, more automated, more modern, better, all of it. And they're inclined to continue with the precision and the accuracy and the customer experience, and extend their contract with us. And so I think the real benefit there is the opportunity to really take that whole batch of customers and extend our relationship and also get increases in utilization while we have those conversations. So it's really a nice opportunity, and it was a nice surprise, something we hadn't called out. It has been years in progress, and it's a really nice machine. So I do think it will kick off a nice refresh and extension cycle in the Point of Care lab side for the chemistry.

- **Benjamin Charles Haynor - Alliance Global Partners, Research Division - Analyst**

Q. Great. And actually, if I could just sneak in one more. Is there the possibility that you could swap out some of these, the Element DCs that are already existing in the North America markets and those over to International and then swap out the DCX into the practice?

- **Kevin S. Wilson - Heska Corporation -**

  A. Yeah. I don't know that we would move assets from country-to-country. I do think we'll be able to hit lower commitment, lower monthly commitment, so lower the friction, lower the hurdle with the Element DC, maybe get a little higher commitments on the DCX for those that are easy to clear that hurdle rate. So I think it does open up an opportunity for us. There's still a very nice market and still a lot of veterinarians who -- they'd love to do $300 a month in chemistry testing. They're still sold proprietorships with 1 or 2 doctors in them. And we think we can serve them very well with the Element DC. And we think kind of the middle of that market, the DCX is probably the sweet spot. So we'll probably be able to push the minimum commitment down a little bit with the DC and maybe capture some of the smaller practices in North America with it.

- **Benjamin Charles Haynor - Alliance Global Partners, Research Division - Analyst**

  Q. That's very helpful. And again, thanks for taking the question and congrats on the quarter guys.

- **Operator - -**

  A. (Operator Instructions) We will take our next question from Jim Sidoti with Sidoti & Company.

- **James Philip Sidoti - Sidoti & Company, LLC - Research Analyst**

  Q. So Kevin, I think you kind of threw everybody a curve ball this morning with the announcement of the reference laboratory. We've seen that work out really well for IDEXX and maybe not so well when Abaxis did that a few years ago. What makes you think that you're going to be more like the IDEXX than the Abaxis and that you'll be able to make this work in Italy? And if it does work, do you expand it to other regions in Europe?

- **Kevin S. Wilson - Heska Corporation -**

  A. Yes, Jim, it's a very fair question. I think our positions are fundamentally different. And you know me, you followed the industry, I've been in the industry a very long time. So on the student of the industry. What we're doing is extremely different than what Abaxis pursued. And the first was the market, picking a domestic market that's very, very well served by Antech and IDEXX. I think, is a very difficult challenge. And so we're not doing that. The second thing I would say is starting it from scratch as opposed to acquiring decades of customers and goodwill with local culture. And our market share, I believe in Point of Care is higher in Italy than Abaxis was at the time. So a lot of differences and just even geography serving the entire North America market with turnarounds of 2 a-day pickups and all those types of things out of one lab in Kansas associated with the university is a very different model than acquiring and merging it in Milan, Italy, just geographically, logistically, all of it. So we're pretty bullish on it. We think it's the right thing to do, especially in places like Italy and France and Spain and Germany and those types of markets, where there's not a firm duopoly that is really hardened. So we think the setup is quite different in the European markets than it was in the United States even 5 or 10 years ago.

- **James Philip Sidoti - Sidoti & Company, LLC - Research Analyst**

  Q. So assuming this works out well for you, you do expect to be able to do this in other regions in Europe, it sounds like?

- **Kevin S. Wilson - Heska Corporation -**

  A. Yes. guys like me on calls like this, I always hesitate to say that because then you could fail in finding local partners and acquiring them and merging them and successfully doing these things. But yes, so I'll just put it out there. That's one of my goals. I think it's a good strategy. And I think we should do it, we should do it more and we should do it well, and we should do it at a bigger scale. So yes, that's the direction we're headed.

- **James Philip Sidoti - Sidoti & Company, LLC - Research Analyst**

  Q. And then it seems like you have quite a bit on your plate with the rollout of AIM in the back half of the year and some of the other new products. It seems like you did really well with the integration of scale. Do you have the right people in place? Do you think you still need to add management and add sales folks in the back half of this year?

- **Kevin S. Wilson - Heska Corporation -**

  A. We absolutely need to add management, and we absolutely need to add sales folks. We're doing that. We've built out a nice human resources team. We've hired some nice executives just even over the last 90 days at the VP level. For expansion, we're bringing on a business development leadership team that will happen here in the next couple of weeks. So no, we're not just building out the commercial side, but we're also building out the inside of the business. And I think we're doing a good job there. We have good people. They're smart. They've the right credentials. They have the right expertise, and we've got growth capital, and we've got a great market, and we've got great results. And so yes, a lot of work to do. I think you pointed that out, and we will need to add people to do it. But I think that's in the guidance that Catherine is sharing with you for the balance of 2021. And as you know, we'll update 2022 when we get to next year.

- **Operator - -**

  A. We will take a follow-up from David Westenberg With Guggenheim Securities.

- **David Michael Westenberg - Guggenheim Securities, LLC, Research Division - Research Analyst**

  Q. Thank you for taking the follow-up. Just a question on Element AIM and servicing the backlog. Do you think you can continue to grow that backlog in the back half of the year? Is that going to be a core tenet of Kevin, maybe your sales force to grow that backlog? And then in terms of launching, I realize you have no control over supply chain issues and pretty much every company is dealing with supply crane constraints. But is there any concern that you have in terms of launch time lines or additional product time lines that maybe this drives into the middle of 2022? I realize supply chain crystal ball is not going to be perfect, but I'll just stop there.

- **Kevin S. Wilson - Heska Corporation -**

  A. Yes. It's a fair question. And it's one that I'm sure my R&D and operations teams are thrilled that you ask, because they live it every day. We've managed through it so far, we've lost weeks that may add up to a month or two, and I've called that out, really, the net effect, what we think is we'll probably be able to install fewer Element AIMs in the October, November, December period, largely just as a constraint of ramping up the volume, and then running them through the initial installation and volume process. And so I think we've been conservative in that, and we've backed out some revenue numbers in the fourth quarter. Just in terms of what the contribution would be. And that is embedded also in the updated guidance. So we still feel good about the consolidated performance. All of which is to say I don't really see a situation where it bleeds into 2022. I think, we've secured the major components. But gosh, you could be delayed by a minor component. You just simply can't ship because screw number 212 is sitting on a freighter somewhere. There's always that possibility, but we're really not thinking that's where we are right now. I think I answered the question.

- **Operator - -**

  A. We'll take a follow-up from Steven Mah with Piper Sandler.

- **Poon Mah - Piper Sandler & Co., Research Division - Director & Senior Research Analyst**

  Q. Thanks for the follow-up question. So just continuing on Element AIM. How many early adopter instruments are currently in the field? And can you comment on any preorder strength that you have right now?

- **Kevin S. Wilson - Heska Corporation -**

  A. So preorder trends, I think it's fair to say we have more preorders than we can manufacture at scale and deliver in the fourth quarter. So we feel great about that, but obviously, customers want their -- they want their product as well. So it will probably take us through the first quarter of next year to work through the balance of the preorders is my guess. And we continue to get preorders. But customers have been communicated very clearly that if they're a preorder today, they're not to expect a shipment in 2021, but they should be looking to the first quarter of 2022. So in terms of analyzers in process, we did meet our goal of putting analyzer in a third-party clinical environment by the end of the quarter. But in all candor, just barely. And so again, I think we're probably delayed on that by a few weeks, but we've got a handful operating and running samples and we think the results support our forecast that we'll be at manufacturing release by the fourth quarter.

- **Poon Mah - Piper Sandler & Co., Research Division - Director & Senior Research Analyst**

  Q. Okay. Great. Thanks and congrats again.

- **Operator - -**

  A. It appears there are no further questions at this time. I would like to turn the conference back to Mr. Wilson for any additional or closing remarks.

- **Kevin S. Wilson - Heska Corporation -**

  A. Well, thank you, and thanks, everybody, who joined the call. We appreciate the follow-up questions. I hope it's a helpful call. To close, pretty clearly, Heska accomplished a great deal in the second quarter. As I concluded in our last call as well, we expect to continue to execute throughout the balance of 2021 and into 2022. I look forward to updating you on the next quarter. We're working hard to make it another wonderful call. And until then, thanks for your continued interest and support of our work here. Be safe, avoid COVID arguments, count your blessings and most importantly, take your pet to the veterinarian even though he's really busy and his staff is a little bit tired, but he still wants to see your pet. So we appreciate it. We appreciate your interest in our industry and look forward to updating you on the third quarter here in the next month or two. Okay. Thanks. Bye.

- **Operator - -**

  A. That concludes today's presentation. Thank you for your participation. You may now disconnect.