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

Presentation

- **Operator - -**

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

  At this time, I'd like to turn the conference over to Jon Aagaard, Head of Investor Relations. Please go ahead, sir.

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

  Thank you, and good morning, everyone.

  Welcome to Heska Corporation's Earnings Call for the Third Quarter of 2021. As a reminder, today's conference is being recorded. I am 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 will 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 disclaim any obligation or intention to update any forward-looking statements to reflect events that occur after the time such statement was made.

Also 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 2021 results, please note, all references to growth refer to growth compared to the equivalent period in 2020, unless otherwise noted. (Operator Instructions)

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 -**

Thanks, Jon, and good morning, everybody. I know you've got a full day, and I appreciate that you're taking the time with us this morning. We've got a lot to cover, so I'm just going to go ahead and jump right in.

Net-net, Heska had a great third quarter with a mixed financial scorecard truly. Now, I know every CEO says the quarter was great, but except for supply challenges that we worked through in the period, we did well on balance. So let's unpack where we are for 2021 as we prepare for 2022.

In the third quarter, supply chain delays in raw materials caused us to miss about $2.9 million of sales in our contract manufacturing vaccines and therapeutics lines and delays of a few weeks in computing and imaging components affected launches in our new line of digital radiography products in international to the tune of about $1.5 million in the third quarter. We believe these issues have been resolved in time for the fourth quarter, and we believe these issues are in the rearview mirror.

On the overwhelmingly positive side of the ledger, Heska continues to follow through on our promises. We are encouraged by success in almost every major metric and goal as we work to conclude the balance of 2021 within our guidance. Catherine will detail the financial scorecard shortly, but I'd like to take a few moments to detail the strategic scorecard.

Up first, Element AIM is now in full commercial release. For those new to Heska, Element AIM is the world's first and only urine and fecal analyzer. Heska had a vision several years ago for this transformative artificial intelligence microscopy platform for urine and fecal testing at the Point of Care. While the competition postured and pivoted and settled for rebranded of repurposed human testing platforms with limited utility and technical difficulties, Heska innovated.

I am so proud of our Heska teams for their full-steam-ahead efforts these past several weeks as we have reached manufacturing at scale and general release milestones. We have about 90 installs on the docket for this fourth quarter with 15 already installed. Initial user feedback and surveys have been great. Our teams are in place and trained, and supply chain and manufacturing lines in New England are up and running well at volumes that are supportive of our goals for 2022.

We continue to anticipate meaningful financial contribution from Element AIM in 2022 and beyond in a market opportunity for automating millions of dollars now already being done manually per year. While it is still early days, I can't be more thrilled with this major, major successful innovation and launch, and I hope investors are pleased as well.

Up next is this week's announced acquisition of VetZ of Germany, a leader in advanced practice information management software, or PIMS; and picture archiving and communications software, or PACS. This is a key leg of the stool for anyone wanting leadership in our markets. And with VetZ, Heska enters the all-important PIMS, PACS space with a very strong leadership position and team in the most important geographies.

To review, the summary of the strategy is simple. Heska has leading positions in point-of-care diagnostics and key geographies. PIMS and PACS is the connecting puzzle piece that fits wonderfully into our subscriptions and bond Heska to our customers for decades. VetZ has demonstrated PIMS and PACS leadership within the highly advanced demanding and all-important German market, where Heska is already focused, very strong and going deeper.

Heska has over 7,000 customers, most without VetZ, PIMS and PACS. VetZ has more than 3,000 PIMS, PACS customers, most without Heska Diagnostics. Heska has a leading expert field sales force and support team that is many multiples larger than VetZ and in many more countries. VetZ has experts in software development, connectivity, all aspects of clinical business logic and associated services for clinics of all sizes but especially for the all-important middle, large and mega hospital segments that we cover at most.

The fit is great. Together, we are much stronger to invest, innovate, expand to new geographies and scale. Together, we are better than the competition. In this press release, you'll find lots of information, and I encourage you to read it.

Okay. So let's continue to update the scorecard. As we start to reach the end of our multiyear Act 2, we have doubled our customers, geographies and product revenue streams served while continuing to win in our core baseline business. Those were our stated goals, and we have met them. We have a subscriptions business model that puts us at the very trusted center of the veterinarians business for decades. We stand to top the innovation and value creation chain.

Our sales are growing, our margins are growing, and we have assembled a full stack of products and geographies to win.

We've invested many millions of dollars directly in our business while generating operational cash. We have collaborated and partnered smartly with technological leaders to directly and indirectly benefit from an additional many hundreds of millions of dollars in research and development innovation. We've invested tens of millions of dollars in acquiring early revenue teams, capabilities and technologies along with tens of millions more invested in minority positions and technology developers for the future.

All of this is a smart proxy for research and development investment.

While succeeding in these strategic initiatives, we have also captured the stepped-up growth levels of this past 18 months through COVID-19 as our new financial metrics denominator. We are now well-positioned to grow very nicely going forward off of that stepped-up base with our full line subscription stack to win at scale and reinvention in our upcoming Act 3 Sprint.

Look, as we entered 2021 with an Investor Day presentation indicating $225 million to $235 million in sales for 2021 and $250 million to $260 million in sales for 2022, we will leapfrog our 2021 goal and achieve our 2022 goal this year. And I think that's remarkable. And we -- and while we will update you fully on our full year ending call on our normal schedule with such rapid headline growth, it's also good to see that on top of these accomplishments, our contract subscription value CSV scorecard reflects and is tracking our headline success so far this year.

For example, we finished 2015 with $38 million of minimum CSV, and we will finish 2021 well in excess of our 2021 target of $154.1 million because we surpassed this goal in July of this year. We ended 2015 with $701 per month of North American average monthly CSV. And we will finish 2021 well in excess of our implied 2021 target of $1,093 because we surpassed $1,200 in July of this year.

Without belaboring the point, it is clear that our customers are doing well and that we are privileged to be doing well in long-term partnership with them. That's always been our plan, and we have bit by bit shown some of our growing capability but not all of it. We are thankful for the support of investors and are glad for those that have invested with us for extended periods of time to capture substantial returns. I think you should keep doing that. We have created substantial intrinsic assembly and optionality value these past 8 years. And in my opinion, the best is yet to come.

But while I am thrilled with our 2021 financial and subscriptions performance, I'm even more thrilled with our 2021 strategic and business development accomplishments. Regardless, they both underpin my expectations for strong growth next year and beyond. While we will update our 2022 outlook on our normal scheduled call during our full year ending call, I anticipate a strong update for many reasons. For those new to Heska, I'd like to take a few moments to touch on just a few of them.

Our balance sheet and culture has us well-positioned to play offense within a wonderful pet healthcare space that is experiencing multi-decades growth. We have great capital in hand, and we have great relationships and decades of dedicated domain expertise to win at scale and reinvention. We work hard and do the hard things required to manifest value, and we have a long track record of doing so, and our momentum is accelerating.

Building on 2020, which was transformative, in just 2021, Heska has assembled for veterinarians a unified offering housed directly within the Heska family to serve all of their diagnostics and informatics subscription needs. Let's take a moment to go through what this means because it's an incredible assembly.

Heska possesses an expanding, fully refreshed and leading point-of-care blood diagnostics family that is trusted and preferred as the best available by many thousands of veterinarians around the world and for years under subscription. Heska has invented and has begun full commercial launch of the world's only point-of-care urine and fecal diagnostics analyzer and consumables platform with the launch of Element AIM to address market needs already occurring manually at the Point of Care to the tune of hundreds of millions of dollars each year.

Heska has launched the industry's next-generation 100-micron high-definition digital radiography that is driving a wonderful upgrade cycle that will continue through 2022. Heska has entered the important telemedicine specialist service market with our acquisition of Lacuna Diagnostics for telecytology in February of this year.

Heska has entered the rapid single-use diagnostics market to address needs of approximately $500 million per year through our acquisition of Biotech Laboratories in September of this year. With fantastic products in heartworm, line, auricular and a plasma, FIV, FeLV, parvo and many others, Heska enters the space with a leading portfolio and performance for global sales in subscription and otherwise.

Heska has made its entry into the European reference laboratories market with our acquisition of BiEsseA in Italy in July of this year, a strategy we intend to scale and expand in other geographies. And this week with our acquisition of VetZ in Germany, Heska has entered into the practice information management software competition with a strong technological and market share leadership position to tie it all together.

What this team has accomplished so far in 2021 financially is wonderful. With the exception of discrete and largely solved supply chain challenges of about $4.4 million in the third quarter, I'm pleased. What this team has accomplished so far in 2022 strategically is the leap forward that as best I can tell is unmatched by anyone in our industry.

Now as we conclude 2021 well financially, we will also bring to bear our full attention and skills to integrate, expand, invest in and scale our new full subscriptions capabilities across multiple geographic markets. In doing this, we will grow the overall pie while also getting a bigger slice of it. It's simple. Sometimes it's a little bumpy and it's always hard work, but we're glad to do it.

This is the stuff that makes business fun, and it makes it worth doing, finding opportunities to solve problems, grow markets and beat the competition, delighting customers, employees, partners and shareholders in the process, setting big goals to win and then winning in them honorably, rinse, wash, repeat.

Look, we're honored and we're thankful that customers, investors have supported us since 2013 as we do our work. So that's a lot, and it's a lot more words than I usually subject you to on our calls. I'm hopeful that some of it was helpful. I could talk with you about this for hours, but that's not really the work that you or I get paid to do.

So as I think about how to conclude my prepared remarks today, I think I'll just use the same words that I used last quarter. We are a whirlwind of positive activity, results and opportunity. The first 3 quarters 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, 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 to our Q&A time.

Catherine?

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

Thanks, Kevin, and good morning, everyone. I'm pleased to take you through our third quarter results and update you as to how we see the fourth quarter and, thus, full year 2021 turning out.

Heska delivered a strong third quarter financial performance despite some supply chain challenges and a very strong comparative quarter in 2020. Third quarter revenue grew 6.4% over the very strong comparison. Driving the majority of this achievement was our North America segment, which recorded revenue growth of 9.8% for the third quarter. Of note, point-of-care Imaging grew 41.1% bolstered by the product refresh in the U.S. and the continued launch of the Heska brand in Canada. Increased utilization and pricing resulted in 10.1% growth in point-of-care Lab Consumables.

Our International segment results -- revenue results were mostly flat to the prior year. Point of care Imaging supply chain challenges were offset by higher Point-of-care Lab Instruments and other and PVDs. Our consumable sales, while slightly down to prior year, included healthy volumes. As we transition our customers to a better, more unified and profitable portfolio of products included in our long-term subscription program, we expect to share the cost benefit in exchange for long-term relationships via 5- to 6-year contracts.

The success of this program, both revenue and margin growth, has been demonstrated in the U.S.

Our consolidated gross margin increased approximately 60 basis points to 41.9%. Despite the low gross margin drag from accounting for lab equipment new subscriptions revenue, International segment gross margin improved 280 basis points to 33.3%. The conversion of our customers to the more profitable portfolio under their subscriptions was a significant contributor to this increase. This is excellent sequential follow-through from the most recent prior quarters.

As a reminder, when we acquired these international assets in early 2020, we believed there was substantial opportunity to bridge their margin close to the North America margin. We continue to work toward achieving the synergy.

The North America segment delivered solid gross margin of 47% in the third quarter, a decline of approximately 130 basis points, which was largely attributed to idle plant charges in our OVP and PBD lines due to raw material supply disruption as well as some other product mix impacts.

Operating margin declined 440 basis points to negative 4% because of increased operating expenses of $4.5 million. Higher cash compensation including short-term incentives as well as stock-based incentive costs were the primary drivers as the company continues to achieve its strategic objectives. Additionally, general and administrative costs were higher due to increased consulting and other professional services and onetime acquisition and other related costs to the business development. Adjusted EBITDA margin declined 590 basis points for the same reasons excluding onetime both costs and benefits and stock-based compensation.

We continue to maintain a strong liquidity position with cash of approximately $223 million. In the quarter, we deployed over $20 million in capital, investing in acquisitions and furthering our strategic plan as we expand into new product offerings, both domestically and internationally.

Now turning to the fourth quarter and full year expected results. As part of our second quarter earnings call, we communicated an unexpected 2021 consolidated revenue range of $250 million to $260 million. Based on experience to date, including some of the factors already discussed such as supply chain disruption and foreign exchange, the more likely outcome is at the low end of the range, resulting in year-over-year growth of approximately 27%. And as Kevin noted, this revenue result puts us 1 year ahead of our multiyear outlook presented only 1 year ago this month. We are reaffirming all ranges previously provided as well as the North America consumable growth rate in excess of 20% for the full year. Adjusted EBITDA margin in excess of 10% is still expected.

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

Question And Answers

- **Operator - -**

  A. (Operator Instructions) We will take our first question from Chris Scott with JPMorgan.

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

  Q. I just have 2 for you. First, can you talk about your international point-of-care consumable results? I think, they were basically flat year-over-year. I know they've been showing some -- last quarter, it was healthier growth. I'm just trying to understand some of the dynamics there.

  And then the second one was just to clarify on the lower end of guidance range. I guess just purely just based on the timing -- the time lines of some of this contract manufacturing and equipment placement with the supply chain as well as FX, or are there other factors that we should consider relative to the update you gave in August? Just any color there also would be appreciated.

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

  A. Chris, thank you. Can you hear me okay, guys?

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

  Q. I can hear you.

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

  A. Okay. Great. So the first question, yes, thank you. I was hoping somebody would ask that. So I'm going to take probably 3 or 4 minutes to explain this, but I think it's worth explaining. So the way I look at it is we're -- I think in pictures, so bear with me, I'll land the plane.

  We're in the process of organizing a flower garden. We bought a business with margins, say, 30%. I said since we bought it, we would grow those margins substantially towards the North America level. And so in the flower garden, there are times, you're going to start trimming some less interesting flowers and you're going to pull some weeds and you're going to put some new flowers in and replace the old ones with ones that you like for 6 to 10 years. So that's what we keep referring to with our rationalization of the products to bring kind of our standardized products.

The effects of moving customers from low-margin consumables to much higher-margin consumables means as part of our mission that we can share the cost savings with the customer on each unit sold while we're more profitable. And so what happens is we get higher gross margins, but for a limited time, it drags on the top line revenue at the same unit volumes because we share some of the cost savings.

So the way I would look at it is, let's say, we sell a rotor for $20 with a 30% gross margin, $6. And then we've now developed a rotor with 70% gross margins. And so we're able to help the customer, we go to the customer and say, hey, we can offer you a 10% savings on that rotor. We're going to upgrade you to a new platform, and we sell you our rotors for $18. Now we're realizing 70% gross margins. We're going to go ahead and share that $2 back with the customer.

So we're still going to realize $12.60 in gross margin instead of $6 like we were yesterday in that customer site. But every rotor that customer uses is only going to generate $18 in revenue as opposed to $20. So the vet saves $2. The pet family probably saves around $6 on that test. We dampened our revenue about 10%, while we gained over 100% profitability.

And so that's -- when that happens at scale, when you're converting as fast as we're converting, that's where you pick up a couple of hundred basis points in gross margin. And so, if you look at a right of way, we always want to grow revenue, but we also want to grow gross margin. And when there's a right-of-way issue, we're going to prioritize the gross margin and go ahead and share some of the top line revenue with the customer, which is really, again, as part of our mission is to save the customer money and do a better job for them clinically at the same time.

So I'm sorry, that was a long answer, but I just -- I think it's a really important one because people look at that number and go, oh my God, it's flat. I look at that number and go, wow, that's great. It should be flat. You kind of want to get that just about right. Now, it's wonderful, if you can get outsized growth in addition to get in the flower bed that you want and all the dynamics that I just -- but again, when a right-of-way issue happens, I'll prioritize faster subscriptions, much higher gross margins and getting those customers over to our product platform.

I think the second question was about the full year guide at the lower end of the range. And I'll just say really there's $4.4 million that we called out with supply chain in the third quarter. We'll run out of the calendar and to get some or any of that back. And then ForEx and the other things, I think that Catherine called out.

Catherine, I don't know, if you want to add any color for Chris?

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

  A. No, I think that's good.

- **Operator - -**

  A. And our next question will come from David Westenberg with Guggenheim Securities.

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

  Q. I might ask -- I'm going to ask a little bit of a pointed question, but I think it's fair for you guys to kind of defend this here. The consumables -- North American consumables did miss me. I think historically, you've said look at this as kind of a market share kind of number. Now we all have access to things like that success data, IDEXX PIMS data. And we are seeing trends of both veterinary volume and veterinary revenue that looks like it's above market.

  It looked like there was a de-sell there, and so it's probably tough to use 1 quarter as an example, but traditionally, we think of you guys as being a little bit more of a market share gainer. Is there anything we can read into that 1 quarter number in terms of where you think you are in market share position? I apologize, I realize that's a pretty pointed question, but I think it would be -- give you the opportunity to defend it.

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

  A. So I'll start. Catherine probably has additional information. We feel good about our market share. We know what our subscriptions are. We know, who's on a subscription and who's getting product every month. And so I really don't think it's a market share question. I think 10.1 is right around where Catherine was guiding. I think our bigger competitor did a little better than that but I wouldn't say earth-shatteringly, so I haven't looked at their numbers in detail.

  So yes, I don't -- I wouldn't say I'm disappointed. I think it actually rolls up with what we think in the fourth quarter to right where Catherine, I think, was indicating for the year.

  So Catherine, do you have anything you want to add?

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

  A. Yes. No. I mean, I think that's spot on. I also think we typically tend to see a slowing from Q2 to Q3 seasonally every year. Last year was an oddity with COVID. I think our major competitor sees the same trend. So...

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

  Q. No problem. All right. And then you punched above your weight in terms of consolidators for your size and percent of market share for consolidators in North America. We did see an acceleration in terms of consolidation. I mean some industry people have 1,500 clinics that are going to get consolidated in 2021, which would be a massive uptick. Do you feel comfortable with your position with consolidated practices? Do you think you continue to punch above your weight -- And do you think that there's going to be continued tailwinds from that? And I'll hop back in queue after this one.

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

  A. So David, I do. We've got a couple of really nice consolidators. So I'm going to use round numbers. Consolidator A is 500 hospitals, consolidators B is 500, and consolidator C is 1,400, let's just say. And we've got A and B and a smattering of smaller ones. But I think of the majors, we feel really good. And those organizations are doing great. They're acquiring. It's very competitive, but I think they're acquiring their fair share. And over time, I think we get to participate in that.

  So yes, we like the consolidators, and we think that's a favorable trend because, as you pointed out, we think we do have a higher percentage than our just general market rate. And as the consolidators get bigger at a faster rate, that should help us, so yes.

- **Operator - -**

  A. And our next question will come from Ben Haynor with Alliance Global Partners.

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

  Q. Can you hear me okay?

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

  A. You bet.

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

  Q. Just a couple of quick ones for me. On the VetZ acquisition, you mentioned some of the numbers, the 7,000 accounts you have, the 3,300 that they have. But can you maybe give us a sense of how easy it is to cross-sell in both directions? I mean, I would imagine that it's somewhat easier to maybe swap out instruments than it is to convert someone over to a competitive software suite. But just wanted to kind of get your sense of what you think can happen on that front and what's easier or harder or what we should expect going forward.

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

  A. I think that's right. It's always harder to get somebody to switch their practice management software. There were 2 German assets that I have coveted since 2009 when I got back into the vet space. One was Skill, and the other was VetZ. And so to finally get to be partners with VetZ on a direct basis, I've worked with them for a very long time, is a really big deal.

  And part of the reason is -- it answers several questions. Obviously, we can place analyzers in their users, and I think tighter integration and those types of things will be wonderful. I think the ability to trend and do other things between reference labs and point of care, those type of solutions is wonderful. I think moving things to mobile is wonderful. I think adding extra value through their [PESXL], so think fulfillment, to us, the veterinarian is like wholly sacrosanct.

It's the only thing, is the channel that we support. And I think VetZ has some really great technologies that help veterinarians directly with pet owners and pet families and fulfillment and things like that.

So I think those things can be done even if they're not switching out their entire system -- (inaudible) management system immediately. It also answers questions for us in competitive accounts where maybe the current practice management solution isn't up to snuff or doesn't offer proper levels of integration or capabilities. And so to be able to say, hey, we can take the responsibility for the whole experience, I think, is a great deal.

And the business logic piece, I think, is super critical. These guys have a really, really strong position in some of the biggest, if not the biggest hospitals in the world, from the largest universities in the world with hundreds and hundreds of workstations and users to specialty hospitals. And the workflow and business logic that they've developed in those spaces, I think, is really kind of best-in-class. It's something that I think will enhance our reputation and certainly our footprint in some of those bigger hospitals.

So it's just great all the way around. I can't find a negative other than it took me, I don't know what is that, 12 years to make it happen. Other than that, I can't find a negative.

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

  Q. Okay. And just when the cost of logistics is walking off the software, I mean is it a tougher thing to transfer the data from an old or a different software solution to the VetZ solution? Or is it more about training the personnel? Or are these things kind of swap-outable or relatively [easily], if you can get buy-in from the account?

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

  A. So the conversion tools and technologies that VetZ has are extremely powerful. And they've done data conversions with just about every major practice software solution competitor out there. I think the whole market, and I think our competitors agree, is in for a really, really substantial refresh cycle. So you are seeing more investment in the PIMS space. And so converting people, converting their data, I don't think is a barrier. The better providers have good technology for that.

  Workflow is always an issue, and so that's where having 25 years of experience like VetZ does and super highly trained, very precise wonderful German teams, I think, is a good thing just in terms of converting people to the platform and making them happy.

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

  Q. Okay. That's helpful. And then lastly for me on some of these acquisitions that you've made elsewhere. On the point-of-care rapid diagnostics, when do you kind of envision those hitting the market? And then is there any additional color you can give us on the Italian lab?

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

  A. Yes. So we do see rapids hitting the market in 2022. And the Italian lab, it's early days, July, and it's going well, and we're working through the bundling opportunities and all those types of things. So I think I'd call it out. It's a small lab. It's a learning and scaling opportunity for us. It's been around since 1978, I think. I think, it's Europe's oldest continuously operating veterinary reference lab, and so we think it's really a great place to get good learning while servicing primarily that Northern Italian market. But it's going well.

- **Operator - -**

  A. (Operator Instructions) We'll now take a question from Jim Sidoti with Sidoti & Company.

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

  Q. You're not the first company that has reported supply chain issues in the quarter and some costing pressure. Can you just remind me, when you sign a long-term contract with your customers, do you have any escalators in there for inflation?

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

  A. So we do. We've always had since we began the programs in 2013, 2014. We've always had a CPI adjuster in there. So our price increases generally are about 4% under those contracts, and we don't go above that with the exception of in periods where consumer price index is above that, at which point we match the CPI. So we feel covered there. And we aren't seeing price increases on the supply side. We generally have contracted those, in most cases, on a fixed basis.

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

  Q. Okay. So I mean you must be seeing some labor cost increases just like the rest of the world.

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

  A. Yes. I think that's not specific to Heska. I think everybody will see that. So yes, we're not immune to it.

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

Q. Okay. All right. But it sounds like you do have some leeway in pricing to absorb some of that increased cost. And then on the 3 acquisitions you've done most recently, the reference lab, the point-of-care products and the practice management software, can you give us a sense -- I know you don't want to get into details on guidance or whatever, but are we talking single-digit millions, tens of millions? Just give us a ballpark on what you think the annual revenue contribution from these 3 deals will look like once they get up and running.

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

  A. Sure. So the only one -- so the VetZ, the PIMS business, you could think of that as a kind of a $10 million additive on an annual go-forward basis as our starting point. It's a profitable business. I think, we did well in acquiring it. But you could think of it as about a $10 million piece. We'll get more specific just obviously in terms of the whole 2022 add, but that's about the size of it.

  The other 2, the reference lab in Italy, very small and just in terms of revenue relative to our other revenues. And then the Rapids business, that's really that's really about menu and how fast we get it on the market. It's a $500 million market, and we're starting at virtually none, certainly none that we manufacture. So that one I don't want to put a number on for 2022 until we give 2022 guidance.

- **Operator - -**

  A. Our next question will come from Elliot Wilbur with Raymond James. I apologize, It looks like we'll take a question now from Chris Scott with JPMorgan.

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

  Q. I want to -- appreciate all the color earlier on the [gardening] analogy. I just had a quick follow-up though. If I think about international point of care, should we be thinking about this kind of dynamic continuing into 4Q and, I guess, into 2022 as you convert over accounts, so a scenario where maybe the sales growth might be a little bit lower, but the gross margin improvement is kind of offsetting that? Or is this more of just a one-off phenomenon with just the way account conversions play out this quarter that skewed more towards some of these products that had maybe some sort of like kind of cost savings for the customer but much higher margin for you?

  Just trying to get a sense just on a go-forward basis, is this kind of representative of what we should be thinking about the next few quarters.

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

A. My sense is it's another couple of quarters. It's not years, but it's another couple of quarters. And again, I think that's kind of built into the guide that Catherine has given for the year.

- **Operator - -**

A. And my apologies, we'll now hear from Elliot Wilbur with Raymond James.

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

Q. Can you hear me all right?

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

A. We can.

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

Q. Okay. Not sure what happened there. Just a quick question for Catherine. If you could just provide what the currency impact was in terms of impact on growth in the International segment in the quarter.

And then for yourself, Kevin, obviously been a lot of noise in the marketplace lately around Element AIM. Maybe you could just do a high-level flyover again in terms of what you think the market opportunity is there and outside of some of the obvious factors in terms of time and convenience and the like, but just what are the key differentiators of the platform and, ultimately, what are some of the levers that drive initial uptake.

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

A. Catherine, you want to do ForEx, and then I'll do Element AIM?

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

A. Yes, I said the foreign exchange impact to the quarter is probably about 100 basis points on the growth.

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

Q. I'm sorry, Catherine, is that for -- is that across the entire top-line or for the International segment?

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

  A. Did we lose Catherine?

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

  A. Oh, I'm sorry. I'm sorry. I was talking on mute.

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

  A. You're on mute?

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

  A. I was. Sorry about that. So let's just say on a constant currency basis, growth was at about 5.5% for revenue versus the reported 6%. Can you hear me?

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

  A. Yes.

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

  A. Okay.

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

  A. Is that what you needed, Elliot?

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

  Q. Yes. And then just (inaudible).

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

  A. Okay. So Element AIM, so let's go through it real quickly. Element AIM goes into clinics. The current pricing promotion is $1,000 a month minimum commitment for 72 months. And the consumables cost $15 per test for urine and fecal. And there is a fecal prep device that costs an additional 5 that you only use when you use fecal. So just in terms of utilization, you're looking for only 3 to 4 a day between urine and fecal. And most veterinarians don't find that a particularly high hurdle.

  So that's what the economics look like. So you can see why we think it's meaningful. It's really closely in line with our chemistry and hematology business, which would be the biggest part of our core lab.

In terms of differentiators, look, so there's a urine product out there. IDEXX SediVue, that product is a repurposed, rebranded human medical product out of Eastern Europe. We looked at it, we're aware of it, and we think we outperform it in urine. We look at more sample. We think we've overcome a lot of the issues regarding looking behind highly sedimented samples and things like that. So we think we have a better mousetrap for urine, and they place thousands of them.

And in terms of fecal, there really is no product that's automating fecal. And with all deference to the wonderful competitor that's launched a fecal slide scanner, we were well aware of that technology a couple of years ago and many millions of dollars ago as well. So we don't think that preparing a slide with fecal and then looking at it under an automated microscope is the same thing. Again, we're looking at much more sample.

We have a consumable that's specifically designed for this purpose. It's a sealed consumable. So remember, we are talking about fecal liquid. Fecal liquid and smearing it on slides and those types of things is not a great thing. We do our computations locally and, we believe, much, much faster, whereas the competition is having to do their AI in the cloud. Especially with Internet speeds and variability, the user experience, we think, is substantially slower, and we just think we have a better mousetrap.

And then when you combine those, we think we're better at fecal, we think we're better at urine, and we do urine and fecal together at great economics. We're not quite sure how anybody would make the case that they should go with a single platform that isn't as good in the one thing that it specializes in.

So does that help, Elliot? There's more. We have sales and marketing teams, and we'll be getting after that a little bit more here in the next month or 2 as we're doing the launch. But does that help?

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

  Q. Yes. No, that's a good overview. Appreciate it.

- **Operator - -**

  A. (Operator Instructions) We'll now take a question from Ben Haynor with Alliance Global Partners.

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

  Q. Just a quick follow-up here. On the Element AIM, did you say there's 15, 1-5 or 5-0, 50 out there in the field already? And then I was also curious about how the Element DC has been received assuming that's out in the field as we speak. Any color there?

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

  A. Yes. So no, it's 1-5. Remember, we called out that we would start full commercial release of production manufactured units, so the full release, and that began in October, towards the end of October. So we've got 1-5 that are customers who have been waiting, who are installed. And then we've got the additional work to do to hit the fourth quarter on the docket number.

  In terms of DCX, yes, you would expect me to say it's going great. It is. We have inventory. Customers are very pleased with it. It automates one additional step for people, and they like it. So there's just no downside to a DCX. And it's just a nice upgrade path for us because now we can hit a lower price point on the DC, slightly higher price point on the DCX.

  And then for the mega hospitals with the DC5X, we don't really think there's a direct comparison. A lot of customers would have to put in 3 or 4 competing analyzers, which they do in some of their large clients. And they count those as individual devices as opposed to just 1 DC5X.

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

  Q. And so on the DCX, are you seeing, I guess, more than you would expect in terms of competitive wins? Or is it more of kind of an upgrade replacement cycle? What's the right way to think about where that slots in and how competitive?

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

  A. I think it's an upgrade cycle. It's a nice to have. It's not a disruptor. And again, I don't think that the new products that our competition has launched regarding simplified or lower-cost hematology or simplified dry chemistry, I don't think those are really disruptive either. They're kind of more incremental upgrades. And so the DCX just makes us more competitive, but I don't know you should be looking for it to grab an extra percent of market share.

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

  Q. Okay. Got it.

- **Operator - -**

  A. And we have no further questions queued at this time, so I'll turn the conference back over to Mr. Wilson for any additional or closing remarks.

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

  A. Well, thanks, operator, and thanks, everybody, who joined the call. I think, this may be our longest call since 2014 when I started doing calls with you. So for that, I apologize.

I just want to simplify an exciting quarter, and I think this sums it up pretty well. We had an extremely strong prior year comparable. We experienced supply chain challenges that hit the third quarter. And we think we worked through them well, but they impact the year by about $4.4 million in the third quarter. We entered a $500 million-plus market with the full commercial launch of Element AIM. We believe that's the size of that market, and we believe in that market after years of work and innovation.

Our core recurring POC Consumables grew 10.1%, as we expected, and I'm happy with that. And I think, as we guided, international products rationalization, the subscriptions conversion, my flower garden analogy, I think, helps people to understand the international consumables number. And that margin capture and those conversions and those subscriptions are going well.

Our CSV, we didn't talk about it after the prepared comments, but to hit those or beat those numbers in July of this year and to have those being run up in the bonus round, I think, is amazing. So we see, with 2 years -- or 2 months left in the year, reaching our guidance for revenue, margin, consumables and most, if not all of our other key things that we discuss often.

We've added multiple key legs to the stool, and we now have a strong foothold or stronghold position in the whole subscription stack that we've been aiming for now for the last several years, including markets that are worth hundreds of millions of dollars like PIMS and rapids. And those are meaningful, obviously, relative to our revenue starting point.

And we see these strengths and trends supporting a strong 2022 updated outlook. 2021 will end for us as a record year in which would leapfrog an entire year of financial outlook and accomplished more business development than many companies can do over several years. And it's a lot of work and we aren't perfect, but I believe we are manifesting outsized value creation within a market that is itself in a multi-decade-long secular uptrend. And that hasn't changed. That hasn't changed with the last 30 days or the last 90.

We will keep at it. We appreciate your interest in our work while we do that, and I look forward to updating you on the next quarter. That's our full year call, and we will update you on our normal details for subscriptions and our expectations go forward. We're working hard to make it another wonderful call. And until then, be safe, avoid political arguments, ignore and avoid smash and grabbers, count your blessings and take your pet to the vet. So we appreciate your time today. Thanks, and bye-bye.

- **Operator - -**

  A. And that does conclude today's call. Once again, thank you, everyone, for joining us. You may now disconnect.