Q4 2021 Heska Corp Earnings Call

Monday,02/28/22 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 – Senior VP, Head of IR
- Kevin S. Wilson – Heska Corporation – CEO & President

Conference Call Participants

- Benjamin Charles Haynor - Alliance Global Partners, Research Division - Analyst
- Ekaterina V. Knyazkova - JPMorgan Chase & Co, Research Division - Analyst
- David Michael Westenberg - Piper Sandler & Co., Research Division - MD & Senior Research Analyst
- Erin Elizabeth Wilson Wright - Morgan Stanley, Research Division - Equity Analyst

Presentation

- **Operator - -**

  Good day, ladies and gentlemen, and welcome to the Heska Corporation Fourth Quarter and Full Year 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.

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

  Thank you, Keith, and good morning, everyone. Welcome to Heska Corporation's Earnings Call for the Fourth Quarter and Full Year 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 may make forward -- 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 and opinions 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 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.

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 fourth quarter and full year 2021 results, please note all references to growth refer to growth compared to the equivalent period in 2020, unless otherwise noted.

And finally, before I turn the call over to Kevin, I want to mention 2 items of housekeeping. First, to supplement today's reported results, please find Heska's new earnings presentation on the Investor Resources page on the company's Investor Relations website. And second, Heska plans to host an Analyst and Investor Day on Wednesday, May 18, 2022, to discuss the company's growth strategy, consolidated performance, including its recent acquisitions and product launches, new product pipeline and multiyear outlook. Details surrounding the event will be forthcoming.

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, John, and good morning, everyone. Before I begin, I'd like to encourage participants to review this morning's release, I think you'll find it helpful. Similar to our release, I'll try to keep things concise this morning.

The summary for this morning is simple. Heska is a far, far stronger company than we were a year ago. Nearly every key metric and strategic initiative is substantially better than at any other time in our history, and we expect to say the same thing to you this time next year. Our outlook for 2022 is for very strong sales growth and strong global subscriptions performance.

2021 saw record sales up 28.6%. North America sales were up 21.2%. North America POC Lab Consumables rose 21.5% for the year and was up as expected over the third quarter. International sales were up 43.1% for the year. International POC Lab Consumables sales grew 42.2%.

Heska subscriptions had a great year. Retention was rock solid, and we captured market share. Active subscriptions grew 25%, months under subscription grew 24% and minimum contract subscription value, or CSV, grew 34%, which was double our strong outlook for 17% growth. Catherine will cover the specifics of the quarter in greater detail, so I'll take the remaining time that I have to highlight a few of my own thoughts and observations in advance of our Q&A today.

About the market. Pet health care is broadly in good shape. We are in the middle of a decades-long super cycle, and after 30 years in the space, I can say that there's no place that I'd rather be in unsettled times than pet health care. Veterinarians are strong, getting more valuable and continuing to increase their focus and utilization on diagnostics. Demand from pet families remain solid. Since the early to middle days of COVID-19 societal adjustments, I've taken the position that pet health care was great before, will be great during and will be great following the pandemic. We're not a stay-at-home play. We're not a return-to-work play. We're not a reflation play. We're just a good, solid play that has probably seesawed a little more than necessary due to narratives in search of facts and in search of momentum.

Up or down, we have consistently held that the step-up in 2020 and 2021 would simply increase the denominator before growth rates normalize to the industry's already strong mid-cycle growth rates, which, for diagnostics in particular and for Heska specifically, has been in the 10% to 20% range. We think that's an encouraging backdrop for Heska and for shareholders of pet health care stocks with diagnostics exposure. We expect to participate within these ranges with up to 17% consolidated revenue growth on tap for 2022. We expect 2022 active subscriptions to grow 25%, months under subscription to grow 24% and minimum contract subscription value to grow 24%.

About our international strategy. Heska's international integrations, products rationalization and products launches are progressing well. Since our first major investments, our international plan has been to trim some products, upgrade the entire portfolio to a unified better-performing product stack, convert our international installed base to multiyear subscriptions and grow alongside our subscribers for decades under higher margin, higher utilization subscriptions. Veterinarians will get better performance, lower costs, higher margins and higher levels of diagnostics utilization, and Heska will get the same things. We're aligned.

This is what we began to do in 2021 and what we intend to largely complete in 2022. The optics of the accounting for this conversion period will, at times, show dampened sales dollars and consolidated gross margin pressure in international, which I see as expected and a good trade in 2021 and 2022 in exchange for benefits in 2023 and beyond, when the conversion and accounting effects will be largely completed or moderated year-over-year. As long as we get good utilization, solid long-term subscriptions, solid on-growing margins, reasonable retention through the transition and placements of long-term platforms with highly expandable product road maps, we are thrilled.

We got these things in our 2021 international efforts. As we enter 2022, we continue to see ongoing success and opportunity in these things from product expansion, rationalization and standardization. We also continue to see a clear path to international customer subscription conversion and growth in average minimum monthly CSV at a rate that is faster than our successes in North America circa 2014, when we pursued similar goals in North America. Our goals for this effort in 2022 are detailed in this morning's release.

About our investment strategy. We've invested heavily in internal innovation, collaborative partnering, licensing innovation and then acquiring prerevenue and early revenue teams and technologies that we can grow quickly to meet our customers' current and future needs for the full bundled suite of products and services that they want. These investments are beginning to convert to financial opportunities in 2022 and 2023.

Our Element AIM, one of our most exciting internal innovations is in full commercial release as the industry's exclusive artificial intelligence microscopy platform designed for automated urine and fecal testing at the point of care. We installed over 100 Element AIM devices in the fourth quarter in North America, a bit ahead of our goal. Initial feedback and enthusiasm has been great, and we continue to anticipate meaningful financial contribution from Element AIM in 2022.

On January 3, we closed our acquisition of VetZ in Germany to become a leader in advanced practice information management software and imaging diagnostics informatics. This is a key leg of the stool for anyone wanting leadership in our markets, and with VetZ, Heska is now in a leadership position.

Today's Heska has created only 1 of 2 or 3 unified offerings to serve all of a veterinarian's diagnostics and informatics bundled subscription needs for leading point-of-care lab and rapids diagnostics, imaging and practice software informatics and central reference lab and telemedicine services. That Heska has done this is remarkable, and there is more to come in 2022. What this Heska team has accomplished financially is wonderful. What this Heska team has accomplished strategically is a leap forward that, as best I can tell, is unmatched by anyone in our industry.

10 years ago, I began to articulate Heska's 15-year plan in 3 acts, and we are executing to that plan. We haven't pivoted. We haven't wavered. From 2013 through 2017, we said we would prove our health and prove our relevance in this coveted market, and we did. From 2018 through 2022, we said we would build intrinsic value and build revenue growth, and we have. From 2023 through 2027, we have said we would win at scale and win at reinvention profitably, we will.

Our balance sheet is in great shape. Our position in the markets we serve has never been stronger. Our teams are better than at any time in our history. Our end markets are doing great, and the diagnostics markets within them are doing even better. Our sales are growing, our margins are growing. We've left over an entire year of our multiyear sales goal. We have a subscriptions business model that puts us at the very trusted center of the veterinarians business for decades. We've doubled the geographies and customers we serve, and we've doubled the products and addressable revenue lines that we offer. We are leading in innovation and value creation, 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.

And now, we enter 2022 with our full focus on expanding and scaling our new full subscriptions capabilities across multiple geographic markets to grow the overall pie while also getting a bigger slice of it. It's simple, sometimes a little bumpy, super busy and always hard work. We're glad to do it, and we're honored and thankful that customers and investors have supported us since 2013 as we do our work.

Now, I'm going to go ahead and turn the call over to Catherine to detail the quarter before we move into our Q&A time. Catherine?

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

Thanks, Kevin, and good morning, everyone.

As Kevin noted, we are pleased to report strong financial performance for the fourth quarter and full year of 2021. I will take you through the reported results along with our outlook for 2022.

Our full year revenue grew 28.6% to $253.7 million in 2021, in line with our guidance and representing double-digit growth in our major product groups in addition to the acquisition of scil now included for the entire year. Our fourth quarter revenue grew to just over $68 million with capital lease placements of our POC Lab Instruments as a key driver in both segments as we began our commercial launch of Element AIM in North America and continued the successful launch of our Reset program in Europe.

Our North America segment revenue grew 21.2% for the full year and 8.3% for the fourth quarter. Increased subscriptions, expanded menu offerings as well as price favorability and the continued strong demand in animal health diagnostics all contributed to significant growth of our POC consumables, resulting in 21.5% and 13.2% for the full year and fourth quarter, respectively.

POC imaging grew 42.9% for the year. We also saw increased demand for both contract manufactured Tri-Heart and our allergy products which drove growth with PVD -- within PVD of 25.9% for the year.

Our International segment revenue grew 43.1% for the full year on a reported basis and 16% if you exclude the impact of an additional quarter of scil results in 2021 compared to 2020. Exceeding our international subscription outlook by 10% was a key driver of growth as we continue to execute on our reset program transition in Europe, a core tenet of our strategic acquisition of scil.

Our consolidated gross margin for the year increased approximately 50 basis points to 41.7%, with expansion seen in both North America and international. Fourth quarter consolidated gross margin compressed 40 basis points to 40.9%.

North America full year gross margin increased approximately 30 basis points to 46.8%. Mix of higher consumable sales and imaging were the key drivers of growth. North America experienced lower gross margin in the fourth quarter of 45.6% as we began to introduce Element AIM with approximately 100 placements.

International gross margin expanded in both the quarter and the year to approximately 33%. We continue to see positive gains in our POC consumables, which has been a key synergy opportunity of the scil acquisition. Product mix within imaging sales also favorably impacted the margin.

Total operating margin for the year was negative 0.4%, an improvement over the prior year by 380 basis points, driven by higher revenue and gross margin improvement as previously mentioned as well as better leverage, operating expenses and lower one-time costs. Partially offsetting this improvement was the impact of the ownership of scil for the full year and increased short and long-term compensation expense.

Adjusted EBITDA for the first -- for the full year was $29.7 million and adjusted EBITDA margin was 11.7%, exceeding our full year outlook of greater than 10%. Higher sales, expanded gross margin and operating leverage contributed to our 2021 performance. Fourth quarter EPS was a loss of $0.05, while the full year was a loss of $0.11. Non-GAAP EPS was $0.35 for the quarter and $1.61 for the full year.

Our balance sheet is strong, with cash of approximately $224 million to end the year. During the year, we generated approximately $5 million in free cash flow and we deployed about $35 million in growth capital, investing in acquisitions and other partnerships.

Now for our financial outlook for 2022. We expect consolidated revenue within the range of $287 million to $297 million, which reflects reported growth of 13% to 17% and a constant currency growth of 15% to 19%. Our guide includes growing our subscription base 25%, continuation of favorable underlying fundamentals relating to demand, price gains, successful placement of approximately 500 Element AIM analyzers, an expanding menu, all resulting in a Point of Care Lab range of $170 million to $180 million.

Coming off an exceptional year for our imaging placements, we are estimating a range of $65 million to $75 million for Point of Care Imaging, now inclusive of informatics or VetZ acquisition completed on January 3. We expect our PVD and OVP product groups to remain relatively consistent with 2021 levels. Based on our current Element AIM placement schedule and investment in sales support I will speak about in a minute, we see revenue acceleration in the second half of the year.

We expect North America to comprise approximately 60% of total revenue, which includes an estimated Point of Care Lab consumable growth rate of 15% to 20%. The remaining 40% of total revenue in our International segment includes an estimated Point of Care Lab consumable growth rate of approximately 5%. Our focus in the international segment in 2022 will be a continuation of reset subscription transition, which impacts the near-term consumable growth rate as we focus on existing customers and exchange price for longer-term economics. We expect to expand our gross margin between 100 to 200 basis points.

While our revenue performance is ahead of our multiyear outlook shared in November of 2020, investment in the business is required in order to continue to execute on our strategic plan. Our investments will be centered around building out research and development capabilities in support of ongoing efforts to commercialize existing and future products, sales promotion and support, and further building of key corporate functions such as IT, accounting and legal.

Our 2022 adjusted EBITDA margin expectation is to continue to exceed 10%. Further, we expect depreciation and amortization expense of approximately $17 million, stock compensation expense of approximately $20 million to $22 million, interest expense of about $2 million. Our annual effective tax rate is estimated at 7% to 12%, which could be further impacted by additional executive compensation limitations and excess tax benefits. We expect to be in a tax expense position.

Our free cash flow generation is expected to be in the range of $7 million to $10 million. And to date, in 2022, we have deployed nearly $31 million in growth capital as part of the VetZ acquisition.

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

Question And Answers

- **Operator - -**

  A. (Operator Instructions) We'll take our first question from Chris Schott with JPMorgan.

- **Ekaterina V. Knyazkova - JPMorgan Chase & Co, Research Division - Analyst**

  Q. This is actually Katerina from JPMorgan on for Chris. Congratulations on the results and update.

  And so the first question is on Point of Care international growth for 2022. So obviously, I appreciate that customer conversions are a headwind. But can you perhaps elaborate on the underlying volume growth trends that you're seeing for that piece of the business? And as part of that, maybe talk about how you're thinking about the first half when you're still seeing all these customer conversions versus the second half growth when we're probably going to see a more normalized number?

  And then the second question is on North America Point of Care Lab consumables growth, so I think you've guided to 15% to 20% growth. Can you provide some rough color around how much Element AIM contribution is in there?

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

  A. Catherine, do you want to take that? Or do you want me to do it?

- **Catherine I. Grassman - Heska Corporation**

  A. I can start. I'm going to go in reverse order, so Katerina, I might need to help reiterate maybe the first question.

  Actually, the first question relating to volume in Europe. We are seeing increased volumes, so we are definitely trading some price in exchange for these long-term contracts, but we do see volume increases across our customer base in Europe.

  As far as the cadence of expectation, a slower comparative in the first half into a transition phase into the second half is the right expectation to have from a growth rate standpoint.

  And then finally, I believe the third question was the North American consumable growth rate and the contribution of Element AIM which, based on our placement target for the year, would yield about 2 percentage points within that range.

- **Operator - -**

  A. We'll take our next question from David Westenberg with Piper Sandler.

- **David Michael Westenberg - Piper Sandler & Co., Research Division - MD & Senior Research Analyst**

  Q. Again, congrats on the good quarter. So just to confirm, I think I heard you say that VetZ is being reported in the Imaging and Other, and to go along with just the previous question about the 15% to 20%, it looks like an acceleration of growth. If it's not -- if VetZ is indeed in Imaging and there's only 2% growth from Element AM, it does still imply that there's an acceleration in the overall growth rate. So can you -- is there anything inorganic that's maybe also pushing it? Because it just seems like a really, really good number. And I just want to confirm, there wasn't or I'm not missing this massive step-up in growth overall, and maybe there is.

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

  A. Yes. I'll start, and then Catherine certainly may have more detail. On Imaging, Imaging had a fantastic 2021. We are combining, and I think it's consistent with how the market sees it, we are combining software informatics and imaging and imaging informatics into 1 bucket, and I think that makes an awful lot of sense. But Imaging won't have a -- in of itself won't have a huge step-up this year off of such a strong number in 2021, so I think you're reading that right. There is a strong underlying consumables growth rate for the company. I don't think, aside from Element AIM and a couple of points there, that there's an awful lot contributing inorganic.

And I would just remind most people, most of the inorganic things we've done are really small in terms of revenue, so I don't think that's what's driving it. We're seeing good utilization. We're seeing good menu launches. We're seeing good subscriber retention, so it's just a lot of good positive factors leading into that number.

And I think that number is pretty consistent. If you look at the deck that Jon posted and referenced on our website, visually, I think you'll see that that's pretty consistent with 2018, 2019 actuals. So when we've kind of indicated we would get back to really strong underlying industry growth rates, that 15% to 20% is really very consistent with what we were seeing in 2018, '19 pre-pandemic.

Catherine, did I get that right?

- **Catherine I. Grassman - Heska Corporation**

  A. Yes.

- **David Michael Westenberg - Piper Sandler & Co., Research Division - MD & Senior Research Analyst**

  Q. Right. Great. Okay. So it is now an organic, kind of 15% or 13%-ish plus grower. I mean, just to confirm. Just a yes or no, right?

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

  A. Yes. I think that's the right way to look at it.

- **David Michael Westenberg - Piper Sandler & Co., Research Division - MD & Senior Research Analyst**

  Q. All right. That's great news. And then just -- and I'm sorry to pick on one thing, but there's -- the one thing I am getting pushback from investors is a little bit on the COGS. I think people expected the COGS to materialize a little bit faster than they are. So can you talk about -- and maybe this is for Catherine, some of the specific headwinds? I know that you're taking price in Europe in exchange for longer contracts, I mean, I guess that's headwind. But is there any other mix headwinds that might be playing into that? And in terms of if there were upside to that, I mean, what kind of has to materialize in the next couple of years to kind of drive that up much faster?

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

  A. Catherine, margins? Margin headwinds.

- **Catherine I. Grassman - Heska Corporation**

A. Yes, see one of the headwinds we're facing -- yes. Yes. I'd just say one of the headwinds we're facing into '22 is some of our contracts for our European entity are purchased in USD, right? And with the strengthening of the USD, that's kind of compressing the margin a bit so we have some work to do there. That's -- I would say that's one of them.

Rolling out the Cuattro branded imaging throughout Europe will take a little time. That launch is largely underway this year and should yield good improvement in gross margin as well, but that's going to take a little bit of time to roll that out and see that within our -- the mix. Europe tends to be somewhat heavy in imaging and imaging across the board with MRI and ultrasound, and some of the sales that are less so in the U.S., so it's a bit of a hurdle rate for us there.

Kevin, nothing else is coming to mind for me.

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

  A. Yes. No, that's -- and the only other thing I would say is the world's just got more expensive. And I think our team has done a great job of managing kind of incoming freight shipment logistics, which does show up in COGS, in certain SKUs. And I think advancing our gross margin the way we have while we're doing subscription conversions, while we're trimming certain products, I think the team has done a great job.

  So yes, there's always a number. There's always a [NIT] , and I'm good with that one. I think we're doing a pretty good job there.

- **David Michael Westenberg - Piper Sandler & Co., Research Division - MD & Senior Research Analyst**

  Q. Got you. Okay. And then maybe if I can just squeeze in one more, I promise the last one. I know you have 4% in your contracts, but I do think there is a stipulation for when the CPI is in excess of that. Do you think that you might need to pull that in excess of 4% price increases to kind of mitigate some of that? Or do you anticipate that happening? And is there any way to think about maybe supply, or if there is pricing levers in the face of supply issues? Or is that just be in future contracts? And I'll stop there.

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

  A. No. Our contracts, I think, had pretty good foresight. So since 2013, we have had a CPI adjustment in there as well, and so we have the ability to raise price. We always try to keep our prices as low as possible for veterinarians. That's part of -- one of our missions. But I think relative to what's happening in the world, we're not getting a whole lot of price pushback, and I think veterinarians, in terms of end user price, are still doing just fine as well. So nobody would like to celebrate 7%, 7.5% price increases, but we do have the ability to take those as inflation kind of chews in. So we have that ability. We try not to use it, but we will use it as -- as is appropriate.

- **David Michael Westenberg - Piper Sandler & Co., Research Division - MD & Senior Research Analyst**

  Q. Congrats on the quarter.

- **Operator - -**

  A. We'll take our next question from Erin Wright with Morgan Stanley.

- **Erin Elizabeth Wilson Wright - Morgan Stanley, Research Division - Equity Analyst**

  Q. Can you speak to the opportunity in rapid assay products? When we should expect, I guess, the heartworm stand-alone product, and what's embedded in 2022 guidance as it relates to Rapids?

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

  A. I think it's still pretty small. I don't know that we're breaking it out. I will say that it's a -- clearly a $300 million, $500 million market in the markets that we compete in. But I think for us in 2021, we've got a reasonably slow, I'll say, single millions ramp. But I don't know that we've broken that out, Catherine, and I don't know that we're going to this year.

- **Catherine I. Grassman - Heska Corporation**

  A. Yes. That's correct. So for this year, single millions is accurate and it is within our PVD category, Erin.

- **Erin Elizabeth Wilson Wright - Morgan Stanley, Research Division - Equity Analyst**

  Q. Okay. Got it. And then on International, how are you thinking about the pace of the initiative with the international reference lab? Is there a deal pipeline there? And how we should be thinking about inorganic versus the organic approach with ref lab internationally?

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

  A. Yes. No, I think that's a great question. So one thing I would keep in mind is there just aren't very many reference labs at scale, so even if there's inorganic, it's going to be very small in terms of revenue base. But the reason that you would do inorganic on very, very small revenue base is, you gain local language, local expertise, local reputation, local relationships in the specialty community providing the services. So ideally, we'd be able to find really strong, but expect them to be very small local partners from which to grow. We think we could expand that business substantially by bundling it with our Point of Care in our Rapids business and our Software Informatics business, so we think we can grow reference lab businesses from very small to not very small.

But if we're doing small inorganic tuck-ins in that regard, there just aren't a whole lot of assets at scale that would move the needle a whole lot. So I think I answered the question.

- **Operator - -**

A. (Operator Instructions) We'll take our next question from Elliot Wilbur with Raymond James.

- **Operator - -**

Q. This is [Hannah Smith] on behalf of Elliot. First, year-to-date, overall vet clinic visits have been off to a slow start, though that has recovered. How does this impact the progression of sales growth in North America over the course of the year?

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

A. Yes. So I struggle sometimes -- this is just me, individual Kevin Wilson. I struggle sometimes to look at the macro vet hospital visits and some of those things on surveys to see it filter in kind of as a one-to-one driver or dampener of diagnostics use in any one quarter. So it's a rambling way of saying I'm not sure there's a direct correlation and causation and how fast that happens.

Diagnostics utilization per visit, I think, is up. I don't think that's controversial, and I think I'd probably focus more on that. I'm probably more concerned about utilization levels per visit which is really behavior of veterinarians and their revenue streams and their profits, and whether they're being disintermediated by online pharmacy and they're being disintermediated by other things. If they're doing more diagnostics as a professional service, I think that's probably a more focus trend for us.

So we have bigger competitors who probably have maybe a little bit more focus on that kind of data. But I personally, and again, this is just me, I've been doing this maybe for 3 decades now, sounds awful long when you say it that way. But I'm a little dubious of the quarter-by-quarter variation just based on kind of the macro visits based on surveys. My veterinarian friends tell me that they're really busy and they're really tired, and they have more customers than they necessarily want on a lot of days, so that's kind of what I hear anecdotally.

- **Operator - -**

Q. Okay. What is the primary driver of the 100 to 200 basis points improvement in gross margin that you're expecting?

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

A. Catherine, do you want to take that?

- **Catherine I. Grassman - Heska Corporation**

  A. Yes, so this -- yes. It's pretty across the board with a higher mix of consumables as part of the revenue profile, those are externally high margin for us. Improvement in our imaging margins, we saw that throughout this year as we continue to launch our branded equipment through our scil subsidiaries. We expect to see that occur in Europe as well, and then mix within our PVD product category as well. Those will all be slightly compressed by instrument placements.

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

  A. And I would layer one more thing just strategically, because this is a broad theme that investors should keep in mind with us. That when we talk about product rationalization and standardization, getting to a globalized standard product where you have thousands of very specific analyzers in clinics is really important, because when you're R&D, and you'll notice we continue to invest in R&. D, when your R&D converts to tests on a standardized global platform, the uptake of that test, which is generally very high margin because the consumables are the highest margin thing that we do, can be very good.

  And so there are times, especially in our international business, where we'll trim less interesting products that aren't products of the future. They're not platforms of the future. The margins aren't great. So we might trade out a platform in chemistry, hematology, immunoassay. Whichever platform we might trim, that might be 25% to 30% gross margin legacy platform. And then what we do is we hope to replace it with something in the 50s and 60s plus over the long term under subscription.

  So that's just a general trend for just building a better business, which is generally what I focus more on is what does it look like over the next 3 to 5 years. And so to grow our gross margin while we're doing that and continue to grow sales while we're doing that, I think, is something that Heska has done a really good job over the last couple of years. I hope that was helpful.

- **Operator - -**

  Q. Yes. That was great. One last question, if I may. Last quarter, you indicated that revenue was negatively impacted by about $4.4 million due to supply chain issues and other delays. Was that business fully recaptured in the fourth quarter? And is there any lingering effect from these same issues that is anticipated to carry out throughout 2022?

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

  A. I think that business was not recaptured, and we tried to indicate that on the call. I think we just ran out of calendar. Catherine probably has more detail on it. And I think supply chain, largely, was in pretty good shape. We have difficulties just like everybody else, but I think we've managed pretty well through it.

So I think by the time we reported it on the call, we felt pretty good about go-forward supply chain, but those were 2 discrete things that were going to be in the number in the third quarter and the fourth quarter, and they were. Is that a fair characterization, Catherine?

- **Catherine I. Grassman - Heska Corporation**

  A. Yes, that is.

- **Operator - -**

  Q. Congrats on the quarter.

- **Operator - -**

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

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

  Q. Guys. Can you hear me okay?

- **Jon Aagaard - Heska Corporation**

  A. You bet. Ben.

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

  Q. Great. So a couple of quick ones for me. One, I guess, more broad and then another one that's a little bit more targeted. But just kind of looking at the big picture, you've got international average monthly CSV at about half of where the North American figure is. I know the expectation is that over time, that gap will kind of close. Just kind of wondering what maybe individual Kevin Wilson's view on that might be. How quickly does that occur? Why does it occur? Is it account seasoning, and just more comfortable with the existing installed base? Is it a larger installed lab per clinic? What all goes into that, and how do you think about that?

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

  A. Yes, it's a great question. We're sitting at about 690 internationally after our first year. And if you go back to 2014, kind of the starting point when we started subscriptions in North America, it's right around 700. So there's really, really a good strong comparison there. And today, we're double that. And so between 2014, 2021, we were able to double from 700 in North America. I think we probably have the possibility to grow that faster in international. I'm really encouraged that the starting point is the same, and so the way you grow that is that job one is to gain the customer.

We've said for a long time, growing alongside veterinarians, which themselves are growing wonderfully, is a key part, right, be their partner for 2 decades and you're going to do really well. And so getting them onto subscription and partnering with them for a long period of time is key. And then you just simply grow the menu. You add new analyzers, which increases their testing. You add new tests to the analyzers that they currently have, which increases their testing.

And then I think Europe, in general, my competitors, I think, agree, is just a little bit behind the North America market in terms of just diagnostics utilization per pet visit anyway, and we see that narrowing as well. I think that will narrow for the whole industry, including our competitors and including Heska. So it's a combination of those. Increased utilization, veterinarians in Europe increasing their diagnostics utilization for pet visit, and then our ability to provide more menu and more analyzers in each address that we're in. And I think we have the possibility to grow that monthly CSV utilization faster in the international markets than we did from 2014 through 2021 in North America. And I'm not prepared to say how much faster, but I do think there's a good analog there.

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

  Q. You're saying like 3 years?

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

  A. See, now you're going to ask me to say how much faster.

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

  Q. Just being a little bit smart on that. And then for my second one, just kind of -- you've got more than 100 Element AIMS out there. Any more color that you can provide on the reception you've gotten, not only from existing customers, but at a recent trade show? I know you've got one coming up here in a week or so. What's been the reaction from kind of trade show attendees and potential customers as well?

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

  A. Yes. I mean, I'll give the standard CEO answer. It's been great. Enthusiasm, excited. It's a really good product. And -- but it's a product launch, right? And so it's new to our people, it's new to our customers. But as a percentage of our customer base, 100 is a tiny percentage. And so the first step is what do our own current subscribers, of which we have thousands, think about the product and the innovation and the possibility to expand their diagnostic testing with us?

  And we get very positive response when we approach customers and say, "We have a whole new category of testing for you that can make your life easier and it can improve the results for pets, and it's priced very well per test. Are you interested?" And they are. So we're getting really good response, and it's a good door opener for our team. So we continue to -- and we called out. Like I say, it's about 500, but I don't think that's overly ambitious for 2022.

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

  Q. Sure. Well, good deal. Well, guys, and congrats on the quarter.

- **Operator - -**

  A. At this time, we have no further questions in the queue. I would like to turn the conference back to Kevin Wilson for any additional or closing remarks.

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

  A. Well, thanks, operator. Thanks to everybody who joined the call. It's been a long call, try not to use so many words, so I'll land the plane simply.

  I want to reiterate what I started with this morning, which is to say that Heska is a far, far stronger company than we were a year ago. Nearly every key metric and strategic initiative is substantially better than at any other time in our history, and we do expect to say the same thing to you this time next year. So outlook for 2022 is strong for sales growth and global subscriptions performance, and we're working hard to achieve that. And Catherine and Jon and I look forward to updating you on our progress on the next call, which -- they always come quickly. So we'll talk to you soon.

  Thanks, everybody, and have a great day.

- **Operator - -**

  A. Ladies and gentlemen, this concludes today's conference. We appreciate your participation. You may now disconnect.