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

Corporate Participants

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

Conference Call Participants

- James Philip Sidoti - Sidoti & Company, LLC - Research Analyst
- 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
- Elliot Henry Wilbur - Raymond James & Associates, Inc., Research Division - Senior Research Analyst

Presentation

- **Operator - -**

  Good day, ladies and gentlemen, and welcome to the Heska Corporation Second Quarter 2022 Conference Call. Today's conference is being recorded.

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

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

  Great. Thank you, Kyle, and everyone. Welcome to Heska Corporation's Earnings Call for the Second Quarter of 2022. As a reminder, today's conference is being recorded. I'm Jon Aagaard, Head of Investor Relations at Heska. And with us this morning was 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 up for questions. Prior to discussing Heska's [results], 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 looking statements regarding future events or future financial performance of the company. We need to caution you that any such 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, aspirations 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. Also during this call, we'll 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 directly comparable measures is provided in our release, which may also be found by visiting the Investor Relations section of our website. In reviewing our second quarter 2022 results, please note all references to growth refer to growth compared to the equivalent period in 2021, unless otherwise noted.

All right. 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 - CEO, President & Director**

Hey, thanks, Jon, and Good morning, everyone. As normal, we'll try to keep things brief this morning to allow time for questions. If you haven't read this morning's release, I encourage you to do so. I will refrain as much as possible from retreading my release quote, which I'm hopeful is helpful to you and responsive to the moment. Catherine will cover the specifics of the quarter, so I'll take my time to share a few observations about our specific performance and my own thoughts on the industry. To start, I'd like to congratulate our teams for working so hard in the first half on important drivers for the second half from accelerated R&D and marketing to online ordering and multinational logistics from sales training and sales to accounting, operations, human resources and business development. Heska teams have set the table for a strong second half while delivering 4% top line sales growth in constant currency compared to last year's very strong 42% Q2 sales growth. That's a big hurdle.

This morning's full guide reflects these results and our expectations in light of the macroeconomic headwinds that are noted in this morning's release, currency inflation, the European situation and a very tight labor market constraining veterinary hospital pet visits are all real and they're in our outlook that has been updated this morning. Also real are many offsetting positives. Heska market share gains for subscriptions continue to have good results at the half of the year. So we intend to again finish the year as we have for many years now with more subscribers than we started. Pet health care market conditions are holding up at healthy levels. Veterinarians continue to rely on point-of-care diagnostics. -- pet families continue to have the funds and the firm commitment to pet health care spending. -- and we anticipate that demand spending and pricing power without demand destruction will all hold up well in the second half and into 2023. -- veterinary hospital capacity constraints will continue at negative rates through the back half.

Most industry checks show lower veterinary patient appointments of about 4%, while hospital sales from those appointments is positive due to mix and price interaction. Early numbers show that Heska test consumables on a quantity basis are capturing between 50% and 75% of visits declines, which is more than offset by price gains. It's real and it can be seen in our numbers, but we see that as Heska launches new platforms in 2022, we can overcome and grow quantities and mix of higher-margin consumables in the face of this year's patient business declines which we do see moderating in the latter part of the back half of 2022 and into 2023. Concerning our product launches, we have several too many to address adequately in our short time, so I will update on a handful this morning.

To begin, Element AIM, the analyzer and consumables are performing wonderfully for veterinarians, clinically and financially. Our manufacturing, QA, operations, artificial intelligence and user interface are all fantastic, and our user experience is even better than we had hoped with new enhancements reducing exam time by over 70% to around 4 minutes in most cases. Element AIM inventory is now in place in our European locations to meet our full year target, with European country launches planned for September. And in North America, our teams are fully trained and are executing in the market with the pipeline and funnel that is more than sufficient to hit our full year target. Next up, our HeskaView Telecytology is also doing well with a nice tailwind from the exit from the market of a smaller competitor.

HeskaView Telecytology is gaining traction with record installations, pipeline and funnel, and we are encouraged that the technology and our dedicated team of boarded specialists will help veterinarians to meaningfully enhance their clinical and financial results. Moving on. Our new true rapid single-use tests were delayed in the first half, but inventory for an extensive and highly competitive menu is now manufactured and now in place in our European logistics locations and European market release has begun. In North America, we have now completed our processes for USDA approval of the product lines regulatory anchor, which is Heartworm, and we expect to be on market in the coming weeks. And finally, our R&D efforts have accelerated. These investments are evident in our numbers this quarter. We're seeing rapid progress in our Vet software development for major new releases contribution in the first half of next year.

Similarly, we remain super excited about our new C cancer screen progress towards launches late this year or early next. To conclude my remarks, I'll borrow from my thoughts in last quarter's message. Demand for pet health care and spending is in good shape. We are in the middle of a decades-long super cycle. For a couple of years now, we have communicated that pet health care was great before, will be great during and will be great following the pandemic. Heska is really well positioned in North America, core Europe and Australia, New Zealand with a very strong value proposition in diagnostics and informatics that can be bundled under a secure and sustainable subscriptions model. Heska also has the enviable position of launching new products to drive utilization quantities higher than the underlying market, which is also quite fortunately supportive of price gains at the same time.

Heska has secured the capital, people, portfolio, supply chain, end market access and contract terms, both in and out to grow in both sunny and unsettled times. We're a good, solid investment with really strong and clear growth prospects and investors have correctly formed capital around Heska to power our efforts to solve problems for veterinarians and pet families and we will be well rewarded for doing so. With that, I'll 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 mentioned, overall macroeconomic uncertainties, including rising inflation, increasing interest rates, foreign currency fluctuations, labor constraints as well as geopolitical strike, especially in Europe, where all headwinds experienced broadly over the past quarter and continuing into the third quarter. The animal health industry, not immune to the news was certainly affected with declining vet visits, albeit compared to a very high prior year comparison, the impacts of which have been widely discussed this earnings season. For perspective, the prior year comparative period was one of the highest growth quarters in Heska's history and record revenue at that time.

  With these factors in mind, I will take you through our second quarter financial performance, and we'll update our outlook for 2022. We reported total revenue of $64.7 million, relatively consistent with the prior year and approximately 4% growth on a constant currency basis. Our North America segment revenue was $40.9 million for the second quarter, in line with 2021 performance, which included record North America point-of-care lab consumable revenue, the highest quarter sales of all quarters in 2021. Our point-of-care diagnostic laboratory products grew in the reported period driven by 5.4% consumable growth. Our consumable growth include uplift from price favorability, partially offset by utilization declines, which were directionally correlated with the decline in clinical visits but held up slightly better as is the case with point-of-care diagnostics historically.

  As we have consistently communicated, the acceleration of demand experienced during the pandemic is expected to normalize and return to historic levels of growth in the post-pandemic period. Offsetting the quarter performance for this segment was lower capital sales of our digital radiography and ultrasound equipment. Our International segment reported quarterly revenue of $23.8 million, a decline of 2.5% on a reported basis. This represented growth of 8.4% on a constant currency basis. Contributing to growth is the acquisition of VTV earlier this year, which established our presence in the practice management information software market, continued transition of our customers to the reset subscription program within POC Lab also contributed to growth. To remind you, the conversion to subscription is targeted at existing customers and will, at times, dampen reported sales dollars from consumables as discounts are shared with new subscriber activations. Additionally, our European markets experienced similar trends as in North America, with the decline in vet visits, which resulted in lower utilization.

  As a result, our POC lab consumables declined modestly by approximately 130 basis points. Consolidated gross margin expanded approximately 30 basis points to 42.3%. The North America segment delivered gross margin of 46%, an approximate 200 basis point decline due to unfavorable product mix and idle plant within our OVP product. All other product categories continue to demonstrate strong margin contribution. International segment gross margin was 35.9%, an improvement of 370 basis points. Heska's international product rationalization and conversions to subscriptions continue to progress well. The expansion in gross margin is indicative of that success, also favorably impacting the international gross margin is our acquisition of ZZ. Total operating expenses were $32.9 million, the increase of approximately $4.9 million was predominantly nonrecurring and extraordinary charges.

Occasionally, Heska will invest in third parties for product development, which can take different forms, including equity investment or debt with coupon and equity components. In the second quarter, as we do every quarter, we evaluated the carrying value of one such debt investment and concluded that a $3.5 million reserve was necessary based on a number of factors, including the deterioration of the overall macroeconomic environment. This reserve represents half of the carrying value of that investment. Adjusted EBITDA was $7 million or an adjusted EBITDA margin of 10.8%, a 220 basis point decline. This was driven by increased investment in recent acquisitions for the development of new software technologies and products as well as short-term compensation as we continue to invest in talent. We had a loss of $0.51 per share in the second quarter. Adjusted earnings per share was $0.34, a decrease of $0.16. Our balance sheet is secured with cash of approximately $172 million. Consistent with our stated strategy, we continue to actively evaluate capital deployment opportunities.

Turning now to our updated financial outlook for 2022. While we continue to be very excited about our second half commercial initiatives and the momentum Kevin outlined earlier, the second quarter trends in clinical visits, macroeconomic concerns, especially relating to labor constraints in veterinary hospitals as well as geopolitical worry in Europe, all necessitate the need for prudency. We are updating our guide as follows: Consolidated revenue of $273 million to $277 million, representing reported growth of 8% to 9% and constant currency growth of 12% to 14%. The PSC lab and consumable range of $160 million to $170 million, including a consumable growth rate of 11% to 14% for North America, which is in line with historical growth rates. We expect our international consumable revenue to be consistent with the prior year on a reported basis and approximately 9% to 12% growth in constant currency. Both growth rates reflect expected price gains. Recall, we are only halfway through our programmatic price increases for the year.

Additionally, benefits from commercial launches of Heska's newest innovations, including Element AIM and Rapid benefit this growth rate. Finally, acknowledging the overall macroeconomic uncertainty, we are lowering our expectations for premium capital equipment placements into our already active existing customer base, but we believe we will be net positive for market share gains on new subscribers and subscription. Our profit-related expectations have improved. Our gross margin guide of 100 to 200 basis point expansion is now expected to be near the higher end of the range, and our adjusted EBITDA margin improved to 11%. In sum, we believe this updated outlook adequately reflects the near-term factors impacting our industry and the confidence we have in our position, the factors driving our unique strategy as well as our ability to execute.

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

Question And Answers

- **Operator - -**

  A. (Operator Instructions) We take our first question from David Westenberg with Piper Sandler.

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

  Q. All right. So let's start with the consumables in North America. It did miss your long-term targets and price increases that you have are tied to CPI. I know that it does -- the increases come on renewal dates. So that hasn't come fully through the P&L. But can you give us any more color around volume dynamics versus that price increases? And are maybe customers only going slightly over their minimums versus maybe before where they're going way over their minimums? I'm just trying to think about how we think about that consumable lines in the light of price increases.

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. Great question, David. So Catherine, do you want to start, and I've got a thought or 2.

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

  A. Yes, sure. David, I would say that like we stated, we saw a similar trending related to that decline was similar in our utilization, obviously, notwithstanding net subscriber gains. So we did obviously pick up some new subscribers in the process. But we did see the price improvement that we have built in place largely obviously overtake that decline. Yes, I mean, I think there's really nothing else to that other than similar trend as the North America that visit decline overcome by price. As far as minimum, maybe some impact there as well, but certainly nothing concerning from our perspective, I think our monthly minimums for our customers are set fairly well. And so we continue to see strong utilization in that regard.

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. Yes. And David, I just -- I look at it pretty simply, if visits are down just say, 4, our quantities are down between 2 and 3, right? We're not capturing 100% of the downtrend in business. So diagnostic utilization is holding up a little bit better than visits. Price is only about halfway baked into the year so far. As you noted, we annualize every month. So only about half of those are in that number. So we're not having to play pricing games and changes, but we have some people who are in their month 11 and they're paying last year's pricing. And obviously, there's an uplift from that, that kind of a snowball effect. And then in terms of just broad quantities, we continue to launch menu into that, that menu acceleration in the back half starts to make it so that we capture less of that downtrend. I see it continuing probably at about the same rates on a year-over-year comparison in the back half.

And so we've kind of adjusted our thought process for the full guide to say that it's not magically just going to get better overnight. Look, there are 41,000 veterinarian shortage, I think, is the latest number that I saw. It's a big number. There's capacity constraints in staff. A lot of hospitals that were open on Saturday and Sunday have cut back on weekend hours. Hospitals that were doing curbside drop-off this time last year, which, in some cases, is more efficient, but certainly less personal with pet owners.

Some hospitals have stopped curbside pickup. People have gone back to work. So the Tuesday at 10:15 in the morning appointment is a little more difficult to fill. Staff has retired, veterinarians have retired. So all of these things are real. And I think on a year-over-year basis, from a high watermark of last year for vet business foot traffic to be down about 4%, I think, is really encouraging, to be honest. And I do see some of that moderating as things normalize. So I don't know, maybe that's helpful.

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

  Q. Yes. No, no. We definitely, I think, appreciate the comps and normal stable animal health market went bonkers in the last year and half. So anyway, I'll just stick with another one around the same kind of consumables in North America. Can you talk about maybe price increases and long-term customer reaction? I know everyone around the market is increasing prices. I mean, from drugs to diagnostics you're seeing an increase in prices all around.

  But just can you kind of think about maybe some of the customer reactions from like maybe a 7%, 8% pricing increases relative to your ability to get maybe get 4% in the next year. And I don't know if you know what I like my question is clear here, but I'm just wondering, is there going to be some longer-term impact on prices in 2022 and kind of the way we think about it in 2023, 2024. I know you're in contract and everything. I'm just kind of thinking more about the way veterinarians think about it. I hope that question was clear.

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. No, it is. I would say 2 things. We have a large competitor who has a higher price today. They're taking over 10% if we factor in the first quarter price increase and the price increase that customers are starting to see this month. So they're 10%, 10.5% on the primary test that we compare on off of a higher starting number. So relative to our competitor, and I don't think the market is pushing back our value proposition actually has expanded while we're taking 8%, 9% on an annualized basis. So I'm really not concerned about that. And I remind people, too, that veterinarians they make money on diagnostics, and they generally use a multiplier effect, right? So if they pay $10 for a test, they generally will sell it for around $25 to $30. That's the margin that they operate their business on.

So when they pay $12 a test, they're going to charge up to $36 for that test. So on a dollar basis, there's lots of inflation there. We're not seeing pet owners push back, right? So the ultimate consumers, pet owners and pet families. We're just seeing veterinarians servicing higher dollar pet interactions, right? They're doing more tests. They're getting more dollars per test, there's price inflation. So I think the root of your question is, is there demand destruction coming and will people push back on price, and we're just not seeing that. And I don't know anybody in the industry that's seeing any evidence of that.

- **Operator - -**

A. We take our next question from Chris Schott with JPMorgan.

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

Q. This is Ekaterina on from Chris from JPMorgan. Two from us. So first, on economic sensitivity, you've touched upon this in the prepared remarks, but can you just elaborate on the dynamics that you're seeing in Europe versus the United States? Are you seeing different trends between those markets when it comes to both pet owner and veterinarian behavior.

And the second question is, we're obviously in this environment with capacity constraints and macroeconomic challenges. And I'm just wondering, is placing new devices like Element AIM and some of the other innovations you'll be rolling out? Is it more difficult in this environment? Or are you finding that veterinarians are still pretty receptive to adopting new products and technologies.

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

A. So I'll start, and I'll take them in reverse order, and then Catherine, if you have thoughts on the European dynamic. I think the European dynamic -- well, so element [a digitaography], anything big people will think more about they read the same newspapers that we read when there's uncertainty. And I think we spoke to that on our prepared remarks that we've factored that in, in terms of just premium placements in our own subscriber base. We're assuming that there's just kind of a natural defensiveness that will occur. We're not seeing lots of evidence of that, but that makes sense. So I think we factored that into our guide. In terms of the European situation, it's a different situation in the United States.

So we don't have necessarily as much of a veterinarian and a capacity constraint as the main driver as much as you have currency, geopolitical risk. People are worried about whether or not they're going to have gas in Germany in the winter. There's just a lot of different uncertainty in those markets. So they're not exactly the same constraints that you're seeing in the U.S., but the net effect is the same. So just you have to be have to acknowledge those potential headwinds. And again, we factored that in when we updated our guidance, took the number down. I think we got those negative factors calculated properly. Catherine, do you want to add anything to that or I think it's pretty straightforward.

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

  A. No, I think that's accurate.

- **Operator - -**

  A. We take our next question from Eli Wilbur of Raymond James.

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

  Q. First question for Catherine. I guess, in light of what is now quite a few different adjustments and/or moving parts in terms of your overall guidance, maybe some additional color in terms of how you expect gross margin trends to progress over the course of the year. I think originally, at the beginning of the year, talked about something in the order of 100 to 200 basis points expansion. But I guess, given the mix shift now, lightering expected to consumables performance, how you're thinking about that?

  And in particular, if you could maybe give a little bit of insight into the gross margin trend in the international segment in the second quarter and why we sort of saw the sequential decrease from the March period, if that was -- how much of that was currency? How much of that was maybe mix light that debt versus other elements of the business, but just some overall kind of high-level views on gross margin performance in the quarter and then trends over the balance of the year? And then I've got a follow-up for Kevin as well.

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

  A. Yes. Okay. So let me just make sure and correct me if I missed the question. But from a gross margin consolidated standpoint for the remainder of the year. So as we indicated around the placements of Element AIM, a large percentage of our target is in the second half. So we will expect to see some compression relative to the first half gross margin, but mix will hold up well. We think, with rising consumable revenue as well. So see it slightly lower than we saw in this first half.

  From an international standpoint, on gross margin relative to the first quarter, it's definitely mix. We saw higher sales of lower-margin equipment within our imaging line, which typically is kind of typically what happens, which is why you see that variation, but very solid contribution from the consumable revenue in the second quarter.

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

  Q. Okay. And then, Kevin, obviously, a lot of uncertainty in terms of short-term end market dynamics and speaking specifically with respect to that clinic visits. But maybe you could just talk about company's execution against its key delivers that you outlined at the beginning of the year in terms of subscription conversion, how you're tracking relative to full year expectations in terms of months and dollars under subscription, both U.S. and EU banks or international.

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. You're welcome, Elliot. Yes. So I noted earlier that our subscription gains and we talked a little bit about on the first call of the year, we're a little bit ahead of schedule and look really positive just in terms of just more gains, more subscribers at the end of the year than we had initially targeted. So I think we're very competitive in the market and sales teams are doing a good job in that regard. As we have a strong back half with some of these placements of Element AIM and Heska view and some of these other things, Part and parcel of that is extensions with existing customers and increases in existing customer contract subscription value.

  And so we see some really good, strong drivers to finish the year well with that. So I like our subscription guide for the year. We're only halfway through the year, but I like it. We only update that annually. But I do think we have an extraordinarily good solid track record in that regard. I think for many years now of hitting or exceeding most of the numbers in that in that chart. So I like where we are as we enter the second half.

- **Operator - -**

  A. Moving forward to Ben Haynor with Alliance Global Partners.

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

  Q. Just first off, a couple of kind of bigger picture ones for me and then one clarification. Just thinking about the capacity constraints that we have ongoing, what's your take on how it kind of alters the industry over time? I mean it doesn't seem like there's a ton of levers you can pull at the practice level. You've got maybe improved workflows, maybe a greater reliance on diagnostics, both of which presumably could benefit you guys.

  But the answer is more bodies and you mentioned the 41,000 vet shortage I mean, doesn't it ultimately come down to either pets not getting the care they need and does that the available care ultimately gets rationed by price or how do you think about how it alters the industry? Because it doesn't seem like this is something that just changes overnight and all some of the capacity constraints are gone.

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. No, it's a fair question and the AVMA and many other bodies in the United States have been wrestling with this question for over a decade. I think it's not a new question. It's like everything related to the last few years. It's been exacerbated and it's a lot more visible just based on the peak and then the normalization. But there have been veterinary shortages for many, many years. I think we had accelerated retirement I think veterinarians who were kind of towards the end of their career, maybe even over 60, I think a number of them just exited the space, which is a logical reaction in the last 2 years. So getting those folks back in a lot of demographic things going on.

So yes, I do suspect there will be rationing by pricing. But I also suspect that markets work and there will be more pop-up clinics that maybe aren't entirely full serve, but they're dealing with wellness and things like that. So I think more kind of big box stores within hospital and clinic trends, I think, is probably a pattern. The market will discover efficiencies and we've been wrestling with it for years.

I do think PIMS is really a key. You'll see investments amongst a handful of us in the industry, really investing in a cloud-based PIMS solution that makes registration makes communication makes follow-ups every time we can reduce an interaction by a minute or 2 and actually improve the communication and experience for the customer, huge gains across millions of interactions. So I do think there are opportunities for companies to solve that problem. So net-net, it's not new. It's just got a bigger spotlight on it.

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

  Q. Okay. That's helpful. And then there's always kind of been that knock out there on how -- what sort of business acumen the average vet practice has. You mentioned kind of the pop-up clinics and maybe some more markets working and, I guess, more business-oriented management. Do you also think that, that ultimately changes the people who decide to go into veterinary medicine. I mean is it -- does it bring in a new kind of more mercenary breed of vet whereas previously, they maybe have the calling of healthy animals and now they're maybe regretted in saying, wow, I wish I would have been a dermatologist or a genital hygienist or what have you, but I guess a long-winded here, but does it also alter who goes into veterinary medicine in your view?

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. So I think this generation of employees, regardless whether they're veterinary doctors or whether their nurses and technicians or front office staff, I think they're missional and I don't think you can find a much better mission than pet health care. So I think the industry has a huge leg up in that regard. So tight labor market, eventually, I think people start to find as long as your competitive wage wise, I think pet health care is a great place to be. I think we'll follow the path that you see in some shortages in human medicine, nursing and technicians is a faster way to fill capacity constraints. So you have nurse practitioners in human medicine helping to fill some of those capacity constraints. So lots of levers to pull here.

  The big thing is pet health care, the demand for pet health care is intact. The bigger thing is, again, rationing by pricing and some of those things just create just some underlying societal issues, right? That health care shouldn't be for wealthy dogs. We shouldn't have those kind of dynamics. But it is a market. And so I think the market will respond it won't affect ‘22 and ‘23. It's a 10-year trend. I think corporate groups also is a trend and it will bring a sophistication and an ability to invest in software and efficiencies, internal residency programs, internal training programs with some of the corporates will relieve some of those capacity constraints. And you probably just need a couple more veterinary hospital or veterinary training programs. I think we're stuck at 27 or 28 or something like that in North America for 30 years, somewhere in that range, and you probably just need to increase capacity of producing qualified veterinarians. So a lot of things at play here.

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

  Q. Okay. And then lastly for me in the press release, you mentioned the new test menu later this year on currently active analyzers and you've got for emphasis large and incremental. I mean is that a description of large being the market -- potential market sizes of the test menu additions that you're planning?

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. Yes. So large an example of a test that would go in that bucket would be the cancer screen. We think that's a huge fully new additive step-up type of test for us. Incremental would be things that go on existing analyzers like an expansion of your hormone testing on the Element i+, for instance. So we have both happening, building out menu and our rapids, building out menu that are incremental. So that's what I'm referring to. It's not large and incremental. It's large or incremental, but we do have both of those happening at the same time.

- **Operator - -**

  A. We take our next question from Erin Wright of Morgan Stanley.

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

  Q. Great. On Element AIM, where you can comment, I guess, where your installed base is now relative to your internal acquisitions at this point? And what's your updated targets for the year in terms of contributions? And how does the placement pipeline look at this point? And can you talk about the innovation progress you mentioned it in the previous remarks here, but is it really just element aim that we should be focused on or will the progress on Rapids and the other new product offerings and analyzers that you were mentioning be material for this year.

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. Yes, you're welcome. So things like Rapids definitely have a contribution for this year and being late in the first half, certainly as part of our first half performance. So I think we've largely resolved that, and we'll have contribution from Rapids in the back half as we had expected. So that's in our updated guide. In terms of Element AIM, we've called out 500 units for the year. I think in Investor Day, we reaffirmed that we expect about 70% of those to occur in the back half. We're sticking with those. We have a good strong pipeline, and we have a good strong funnel. So I really do think we're tracking more than enough customer opportunity, both new, but also in our existing subscriber base to hit that number for the year.

But it's a lot of work, right?

And at the end of the day, you have to execute in the back half and get those things installed. The bigger thing for me is just the positive reception and the performance of the product to find that you launch and manufacture the product and supply chain and everything is just really performing just extremely well.

And then your performance in terms of just exam times and identification of items and the samples and things like that is exceeding our expectations. So you have a really strongly performing product with kind of a good nice low halo around it. So I think we're in a really good position there. And similarly, I think with the HeskaView Telecytology, I think, is also a good contributor for the full year and also for the back half.

So all of those things in our updated guide kind of the puts and takes. And there's still a nod there to the premium placements again, when the macro news cycle is negative and worrying that are minister people too. And so you do have to overcome some of that. But these are profit centers and their sales drivers and their efficiency gainers. And so you really have a pretty compelling message. I think I answered the question.

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

  Q. Yes. No, that's helpful. And then could you give us an update on what you're seeing in terms of the competitive landscape in North America? Has anything changed, giving you more or less opportunity domestically given some of, for instance, sales force disruption at Zoetis, -- any other kind of changes, price increases, et cetera? I'm just curious your thoughts on the competitive landscape here.

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. Welcome. I think that's right. IDEXX obviously is super competitive, very aggressive borrowing and they've been at wafer 20, 30 years. So they keep doing their thing, and we keep trying to chip away at them. I think we'll be a net gainer of subscribers this year. So I think that's really a positive and a non-door team doing a great job. But yes, I think they're over 10%, 10.5% total net price to most customers. So I think that provides us an opportunity in terms of just our value proposition. So that's good. The Zoetis build out of a sales force. We haven't seen a lot of trading. I mean, I think they're doing their own work.

  We don't see an awful lot of trading back and forth of sales teams and marketing teams in the industry, just as a general rule. I mean it happens in spots, but it's not a wholesale issue in the industry. So yes, there they're big, they're good. They don't intend to lose. So we try to acknowledge all that stuff, but we haven't really seen a whole lot of pressure from their efforts yet, but we never bet on the failure of I think, the world's largest animal health company. So we're cognizant that they're good at what they do, and it makes us be better at what we do. So a lot of platitudes in there. But yes, it's very competitive. I guess that would be the short answer.

- **Operator - -**

  A. The next question comes from Jim Sidoti of Sidoti & Company.

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

  Q. Catherine, your G&A was up at $19 million. I assume that's largely due to the onetime write-down and you would expect G&A to come down to first quarter levels in the back half of the year?

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

  A. Thanks, Jim. So for the remainder of the year, I see -- yes, I do think it would come down and effectively be close to the first half of the year, albeit we are continuing to make investments in team and products.

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

  Q. And can you repeat the size of that write-down in the second quarter?

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

  A. It was about $3.5 million included in the onetime and G&A.

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

  Q. All right. And with regard to the volition test, can you just give us a little more color on how that's going, the conversion to a point-of-care test? What's the likely approval process for that? Is that a USDA approval similar to what you're going through for the rapid test?

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. So Jim, it's Kevin. We don't see an approval hurdle. It's a screening test. So I think we're in good shape there. And we've got increased R&D spend, which is in our numbers. And part of that is volition. The other driver of that would be cloud software development and both of those we've accelerated. So once we get it working to a level where we feel like we can produce millions of them get them out consistently, we would aim to go to market.

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

  Q. Okay. And do you think that will be late this year or early 2023. Is that correct?

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

A. I think that's right, Jim. It's really hard to pinpoint, but that's what we're pushing for. And that's what we thought we would do a quarter ago, and I think we're on track to that.

- **Operator - -**

  A. There are no further questions at this time. I'd like to turn the call back to Kevin for any additional closing comments.

- **Kevin S. Wilson - Heska Corporation - CEO, President & Director**

  A. Thank you, operator. We appreciate it. And thank you, everybody, who joined the call. I look forward to updating you next quarter. We'll work hard to make that a good call. I think it's going to be a critical call, and I think it's going to be a strong back half. So until then, take your pet to the veterinarian if you can get an appointment. So with that, we'll sign off, and everybody have a good day. Thanks.

- **Operator - -**

  A. And this concludes today's call. Thank you for your participation. You may now disconnect.