VALUE FOCUS
ANIMAL HEALTH

2013

Q1: Veterinary Services
Q2: Retail & Pet Services
Q3: Veterinary Services
Q4: Pharmaceutical & Biotechnology
Segment Focus

Veterinary Services

2013 Third Quarter

General Overview

Veterinary Services are the largest generator of revenue in the pet industry. Veterinary Services generated $32 billion in revenue in 2012, increasing 5.9% and 6.9% from 2010 and 2011, respectively.

According to Veterinary Practice News, veterinary services made up 35% of pet care industry revenue in 2012, and are expected to increase in 2013 and 2014.

Veterinary services include general pet care, emergency clinics, and specialized services.

Veterinary clinics generally specialize in companion animals, large animals, equine, or exotics, but mixed-use practices are becoming more common, especially in rural areas.

Pets are increasingly being thought of as full members of the household. As this trend of “pet parenthood” continues, a larger variety of services will be offered to ensure the health and happiness of pets.

General Veterinary Practices

Price increases have been the key driver behind increasing revenue in general veterinary practices. Although the number of pets in the US has been increasing, a smaller percentage of pet owners take their pets to the vet, according to Veterinary Practice News. Additionally, increasing vaccine effectiveness has reduced the frequency of vaccine administration, reducing the number of routine visits. Better pet nutrition, reduced pet diseases, and the rise in pet store clinics have further reduced demand for veterinary services. Vet practices can now expect for the majority of their revenue to be generated from lab tests and services, rather than traditional animal care.

Supply of veterinary professionals varies by region. Typically, major metropolitan markets are fully- or over-saturated with practices, while rural or less easily accessible areas are suffering a shortage. Large student-loan burdens are often incurred by veterinarians earning degrees. While experts have conflicting opinions about the overall demand for new veterinarians in the long run, entry to veterinary medicine schools remains very competitive. This rising debt load, combined with relatively stagnant starting salaries, limits the ability of veterinarians to practice in areas with less disposable income.
Emergency Veterinary Practices

The number of emergency enterprises increased as more people bought pet insurance, which covers emergency visits, in 2012.

Emergency veterinary services generated $4.7 billion of revenue in 2012, increasing 1.1% over 2011.

Nevertheless, some emergency vets are expanding their services to include pharmaceutical sales and laboratory testing in order to increase revenues, which have been sluggish since the economic downturn.

Specialty Veterinary Practices

The variety of specialty practices has increased in recent years. Specialty veterinary practices now focus in surgery, oncology, neurology, cardiology, dermatology, alternative medicine, and more. Organ transplants, especially kidneys, are expected to become more prevalent.

There are associated risks of operating as a referral practice, as specialty practices generally require expensive equipment and are generally considered to be more vulnerable to economic downturns than general practices or emergency clinics.
Demand Determinants

As pet owners’ relationships with their pets change, so do the services offered by animal care providers. Since the amount of money being spent on pets determines the demand for veterinary care, disposable income is a significant driver of demand for veterinary care.

The number of pet owners with pet insurance could also affect demand for veterinary services in the future. Pet insurance increases pet owner’s willingness to pay for higher cost treatments. Currently only 3% of dog owners and 1% of cat owners have pet insurance. As a larger variety of plans are being introduced, it can be expected that more pet owners will buy pet insurance. In 2012, 3,000 companies offered pet insurance at a discount, including one in three Fortune 500 companies.

The number of pets in the United States reached peak levels in 2012. The number of pets, however, has not had a significant impact on the demand for veterinary services. The lifespan of pets more directly impacts the demand for veterinary care, as increasing lifespans typically result in more vet visits, often requiring specialized end of life care.

Change in pharmaceutical manufacturing also influences the demand for veterinary care. Technological advancements in animal health have led to more sophisticated diagnostic testing, wider pharmaceutical offerings, and more vaccinations, providing an opportunity for clinics to offer new animal health programs.

Many veterinary clinics also offer care to food animals and livestock. Growing health consciousness increases the demand for veterinary services for food animals. Veterinary Meat Inspectors monitor the treatment and health of livestock. Increased feed costs due to high corn prices have caused many farmers to reduce the size of their heard, decreasing the demand for farm veterinary services.
Equity Market Overview

There are two publicly traded veterinary service companies. VCA Inc ("WOOF") operates 609 animal hospitals in the United States which provide general medical services, surgical services, and specialty services.

VCA also has 56 veterinary laboratories, which provide testing and consulting for veterinarians regarding chemistry, pathology, endocrinology, and other diseases. They operate the largest network of freestanding animal hospitals and 55 veterinary labs in the US. MWI Veterinary Supply ("MWIV") provides products to animal hospitals ranging from dental x-ray equipment to vaccinations and animal food.

VCA’s prices fluctuated over the three months ending June 2013. Overall VCA’s share price has posted total gains of 11.1% and 19.7% over the quarter and the year, respectively. From its lowest price in May to the end of the quarter, VCA’s stock rose 23.4% after higher than expected first quarter earnings and the subsequent announcement of a $125 million share buyback plan.

MWIV experienced a weaker quarter with its share price ending at $123.24, falling 6.8% over the quarter, but rising 17.1% during the LTM period.

EBITDA multiples, measured as the market value of total capital (equity + debt) divided by LTM EBITDA, increased for VCA and fell for MWI Vet Supply relative to the prior quarter, largely driven by changes in stock price.
There are growth opportunities for the veterinary sector. Although cats are the most popular companion animal in the US, vets see half as many cats as dogs, leading some to see feline care as a potential avenue for growth. Cat owners are typically more cost sensitive for veterinary care; thus, veterinary practices must address cat owners’ price sensitivity in order to expand market share. Additionally, mixed animal vets are on the rise especially in rural communities. Large animal practices are in decline due to a decreasing number of family owned farms. Finally, as pets live longer and pet owners are willing to spend more for the comfort of their pets, end of life care will become more popular.

**M&A Activity**

The majority of M&A activity in the veterinary services industry revolves around the consolidation of smaller veterinary practices. Information concerning pricing and multiples for these transactions are not often available. The recovering economy and changing technology will contribute to continued M&A activity in the veterinary services sector of the animal health industry.

**Sector Outlook**

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### Trends in EBITDA

<table>
<thead>
<tr>
<th></th>
<th>3Q 2012</th>
<th>4Q 2012</th>
<th>1Q 2013</th>
<th>2Q 2013</th>
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<tbody>
<tr>
<td>VCA Inc (WOOF)</td>
<td>8.41</td>
<td>8.26</td>
<td>9.03</td>
<td>9.52</td>
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<tr>
<td>MWI Vet Supply (MWIV)</td>
<td>15.74</td>
<td>14.50</td>
<td>17.32</td>
<td>15.81</td>
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<tr>
<td>PetMed Express (PETS)</td>
<td>5.27</td>
<td>6.49</td>
<td>8.19</td>
<td>7.82</td>
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<tr>
<td>Heska (HSKA)</td>
<td>9.95</td>
<td>7.84</td>
<td>9.89</td>
<td>15.50</td>
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<tr>
<td>Zoetis (ZTS)</td>
<td>-</td>
<td>-</td>
<td>18.97</td>
<td>19.74</td>
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<tr>
<td>Pet Smart (PETM)</td>
<td>9.65</td>
<td>9.02</td>
<td>7.37</td>
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<tr>
<td>IDEXX Laboratories (IDXX)</td>
<td>19.10</td>
<td>16.08</td>
<td>15.94</td>
<td>15.44</td>
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</tbody>
</table>

Source: Bloomberg

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## Publicly Traded Animal Health Companies

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Ticker</th>
<th>June 30 Price ($)</th>
<th>52 Wk Perform (%)</th>
<th>Sales ($M)</th>
<th>Enterprise Value ($M)</th>
<th>Debt/Equity</th>
<th>EBITDA Margin</th>
<th>EV/EBITDA (x)</th>
<th>EV / Next Yr EBITDA (x)</th>
<th>P/E (x)</th>
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<tbody>
<tr>
<td><strong>Veterinary Services</strong></td>
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<td>VCA Inc.</td>
<td>WOOF</td>
<td>26.61</td>
<td>21.1%</td>
<td>88.61</td>
<td>7,503.13</td>
<td>21.2%</td>
<td>17.7%</td>
<td>9.63</td>
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<td>MWIV</td>
<td>124.28</td>
<td>20.9%</td>
<td>12.80</td>
<td>2,992.64</td>
<td>0.7%</td>
<td>4.7%</td>
<td>14.94</td>
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<td><strong>Median-Veterinary Services</strong></td>
<td></td>
<td>75.45</td>
<td>21.0%</td>
<td>50.70</td>
<td>5,247.88</td>
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<td><strong>Pet Retail</strong></td>
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<tr>
<td>PetSmart Inc</td>
<td>PETM</td>
<td>67.55</td>
<td>-0.9%</td>
<td>6,838.94</td>
<td>7,503.13</td>
<td>70%</td>
<td>13.19%</td>
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<tr>
<td>PetMed Express Inc</td>
<td>PETS</td>
<td>12.85</td>
<td>5.7%</td>
<td>233.07</td>
<td>258.41</td>
<td>0.0%</td>
<td>12.58%</td>
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<td>8.57</td>
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<td>Heska Corp</td>
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<td>40.21</td>
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<td>20.69%</td>
<td>20.83</td>
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<td>IDEXX Laboratories Inc</td>
<td>IDXX</td>
<td>90.73</td>
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<td>1,319.70</td>
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<td>7.2%</td>
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<td>16.06</td>
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<td>Abaxis Inc</td>
<td>ABAX</td>
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<td>187.18</td>
<td>1,078.26</td>
<td>0.1%</td>
<td>26.36%</td>
<td>21.85</td>
<td>37.97</td>
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<td>Aratana Therapeutics Inc</td>
<td>PETX</td>
<td>7.50</td>
<td>nm</td>
<td>na</td>
<td>54.11</td>
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<td>8.82</td>
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<td><strong>Median-Animal</strong></td>
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<td>233.07</td>
<td>668.34</td>
<td>7.8%</td>
<td>20.7%</td>
<td>18.45</td>
<td>13.93</td>
<td>28.16</td>
</tr>
</tbody>
</table>

Source: Bloomberg

## Median Percent Change in LTM Stock Prices by Industry Segment (Price Weighted Indices)

![Graph showing median percent change in LTM stock prices by industry segment](source: Bloomberg)
Mercer Capital has expertise providing business valuation and financial advisory services to companies in the animal health industry.

Industry Segments
Mercer Capital serves the following industry segments:
- General, Specialty, and Emergency Care
- Pharmaceutical & Biotechnology
- Retail and Pet Services

Services Provided
- Valuation of animal health companies and veterinary practices
- Transaction advisory for mergers and acquisitions
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

Contact a Mercer Capital professional to discuss your needs in confidence.

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