

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.

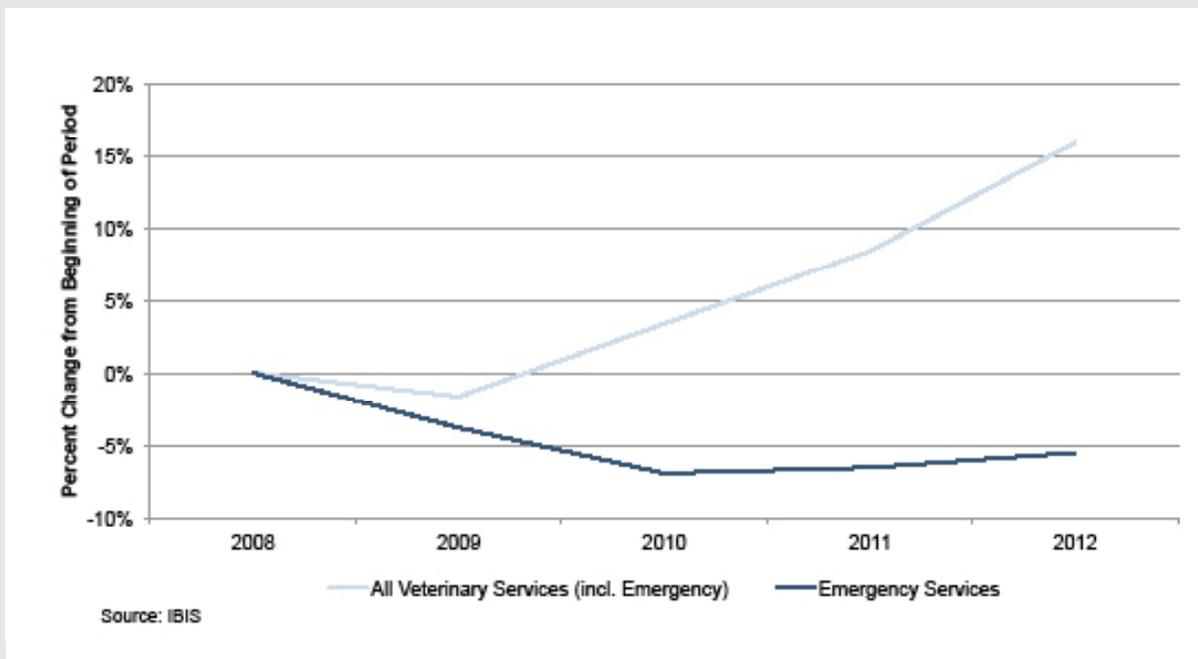
Nevertheless, some emergency vets are expanding their services to include pharmaceutical sales and laboratory testing in order to increase revenues, which have been sluggish since the economic downturn.

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.

Veterinary Services Industry Revenue



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.

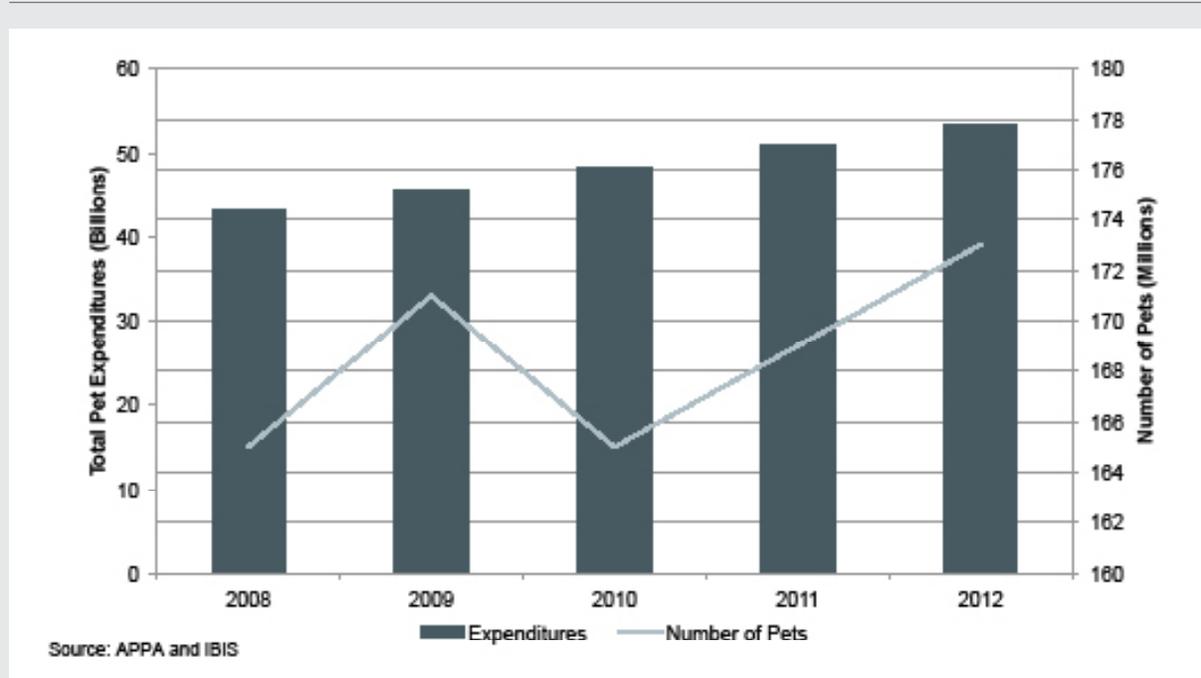
The number of pets in the United States reached peak levels in 2012. The number of pets, however, has not had a significant impact on the demand for veterinary services. The lifespan of pets more

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 herd, decreasing the demand for farm veterinary services.

Number of Pets and Pet Expenditures



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.

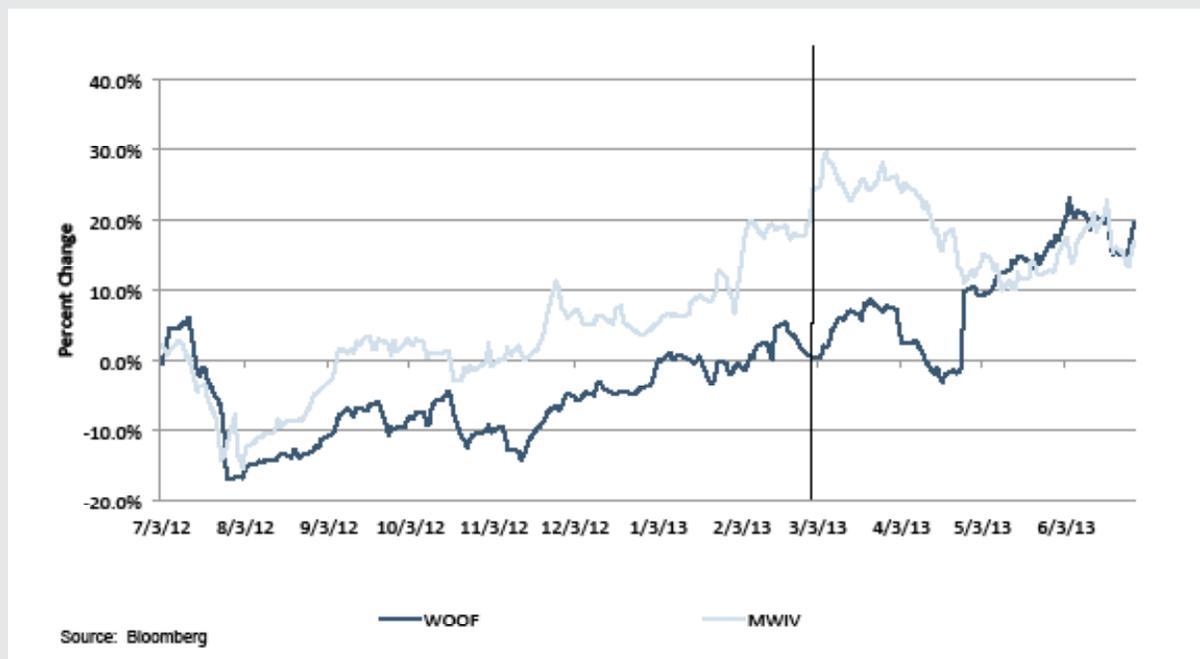
VCA's prices fluctuated over the three months ending June 2013. Overall VCA's share price has posted total gains of 11.1% and 19.7%

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.

Veterinary LTM Historic Stock Prices



Trends in EBITDA

	3Q 2012	4Q 2012	1Q 2013	2Q 2013
VCA Inc (WOOF)	8.41	8.26	9.03	9.52
MWI Vet Supply (MWIV)	15.74	14.50	17.32	15.81
PetMED Express (PETS)	5.27	6.49	8.19	7.82
Heska (HSKA)	9.95	7.84	9.89	15.50
Zoetis (ZTS)	-	-	18.97	19.74
Pet Smart (PETM)	9.65	9.02	7.37	7.97
IDEXX Laboratories (IDXX)	19.10	16.08	15.94	15.44

Source: Bloomberg

M&A Activity

Recently the veterinary services sector has seen trends of consolidation. The industry is changing with the workforce and technology. As technology improves, the appeal of state-of-the-art facilities is attracting veterinarians to multi-doctor practices which can afford the new technology.

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

Continued economic recovery could increase growth in the veterinary services sector. In addition to rising disposable income and falling unemployment, the recovering housing market should have a positive effect on demand for veterinary services. Renters typically face restrictions on pet ownership that are not experienced by home owners. Research has also found that larger households tend to have increased pet ownership.

The veterinary industry is beginning to face competition from retail stores such as Pet Smart, which operated full service veterinary hospitals in 829 storefronts as of early February 2013. Additionally, some pet stores are offering in store vaccinations. As traditional vets expand their practices to compete with in store clinics, emergency vets will face increased competition, since increasing use of preventative measures should decrease demand for emergency care.

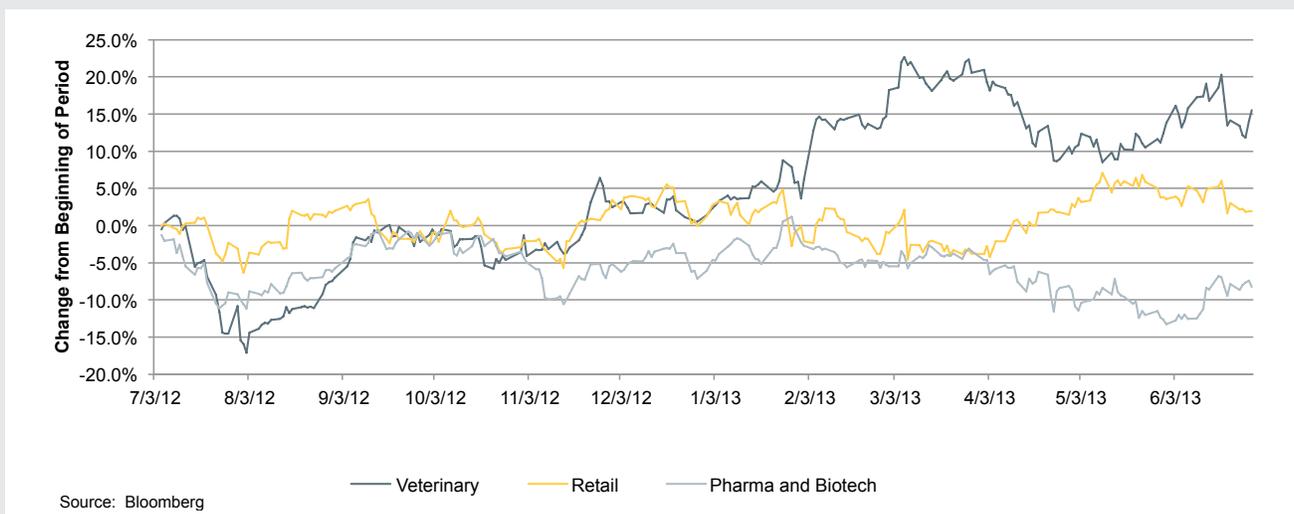
There are growth opportunities for the veterinary sector. Although cats are the most popular companion animal in the US, vets see half as many cats as dogs, leading some to see feline care as a potential avenue for growth. Cat owners are typically more cost sensitive for veterinary care; thus, veterinary 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.

Publicly Traded Animal Health Companies

Company Name	Ticker	June 30 Price (\$)	52 Wk Perform (%)	Sales (\$)	Enterprise Value (\$M)	Debt/Equity	EBITDA Margin	EV/EBITDA (x)	EV / Next Yr EBITDA (x)	P/E (x)
Veterinary Services										
VCA Inc.	WOOF	26.61	21.1%	88.61	7,503.13	21.2%	17.7%	9.63	8.71	51.17
MWI Veterinary Supply, inc.	MWIV	124.28	20.9%	12.80	2,992.64	0.7%	4.7%	14.94	12.49	25.78
Median-Veterinary Services		75.45	21.0%	50.70	5,247.88	11.0%	11.2%	12.28	10.60	38.48
Pet Retail										
PetSmart Inc	PETM	67.55	-0.9%	6,838.94	7,503.13	7.0%	13.19%	8.32	8.16	18.36
PetMed Express Inc	PETS	12.85	5.7%	233.07	258.41	0.0%	12.58%	8.82	8.90	14.28
Median-Pet Retail		40.20	2.4%	3,536.00	3,880.77	3.5%	12.9%	8.57	8.53	16.32
Animal Pharmaceuticals and Biotech										
Heska Corp	HSKA	6.85	-38.8%	72.60	40.21	8.5%	-0.51%	nm	5.91	nm
Zoetis Inc	ZTS	30.61	nm	4,399.00	18,957.00	19.3%	20.69%	20.83	13.93	29.15
IDEXX Laboratories Inc	IDXX	90.73	-5.6%	1,319.70	5,146.46	7.2%	24.28%	16.06	14.86	27.16
Abaxis Inc	ABAX	48.36	30.7%	187.18	1,078.26	0.1%	26.36%	21.85	37.97	39.00
Aratana Therapeutics Inc	PETX	7.50	nm	na	54.11	9.1%	nm	nm	nm	nm
PetMed Express Inc	PETS	12.85	5.7%	233.07	258.41	0.0%	12.58%	8.82	8.90	14.28
Median-Animal		21.73	0.0%	233.07	668.34	7.8%	20.7%	18.45	13.93	28.16

Source: Bloomberg

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



Mercer Capital

Animal Health Industry Services

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:

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- Pharmaceutical & Biotechnology
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Services Provided

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- 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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