

VALUE FOCUS

ANIMAL HEALTH



2013

Q1: Veterinary Services

Q2: Retail & Pet Services

Q3: Veterinary Services

Q4: Pharmaceutical & Biotechnology

Segment Focus

Pharmaceutical & Biotechnology

2013 Fourth Quarter

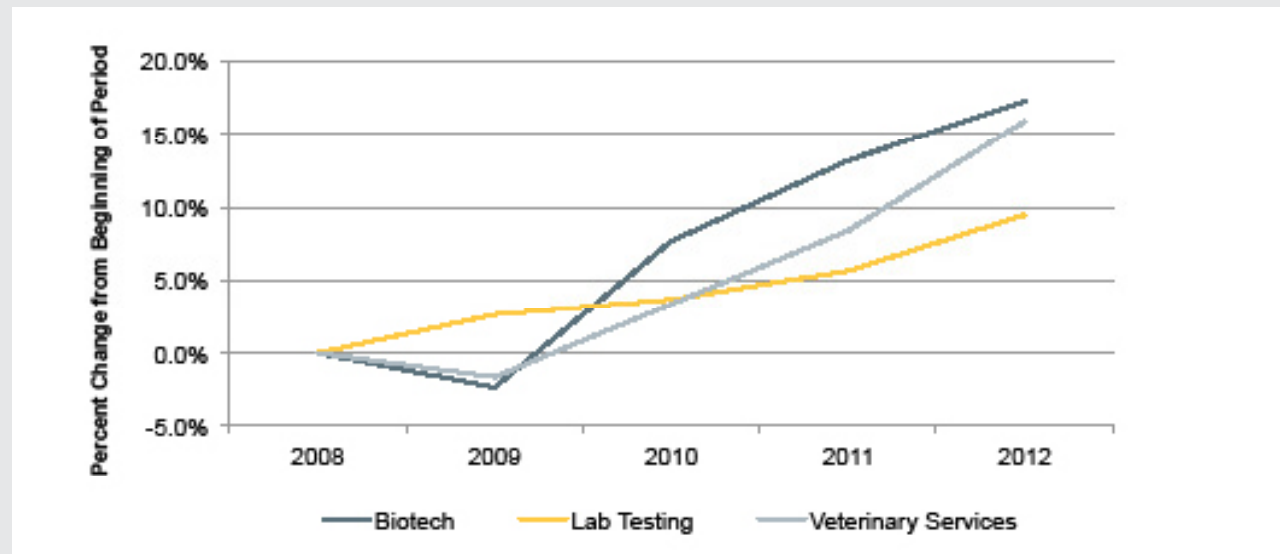
General Overview

The animal pharmaceutical and biotechnology industry works to improve health of both companion animals and livestock. Animal pharmaceutical companies develop and distribute medications, ranging from topical flea medication to heart worm preventative medication to antibiotics.

Veterinary laboratories provide testing and diagnostic services to veterinarians who track and monitor animal diseases. The

biotech industry provides breeding support, diagnostics and testing services, and drugs and vaccines for feed animals. Additionally, some biotech companies focus on developing genetically modified animals to prevent disease and enhance nutritional value of dairy and meat.

Animal Health Industry Revenue Comparison



Source: IBIS

Pharmaceuticals

Pharmaceutical companies often rely on third party suppliers to manufacture some of their products. Additionally, they sell their products to distributors who market the products to veterinary services. Pharmaceutical companies' reliance on suppliers and distributors places them in a position of risk. For example, Heska's receipt of proprietary products from third-party manufacturers makes up 30% of its revenue in 2012. Aratana relies on external manufacturers for their small molecule and antiviral products.

Laboratory Testing

The routine use of diagnostic testing at veterinary clinics has increased demand for veterinary laboratories. The veterinary laboratory testing industry generated \$4.3 billion in revenue in 2012, increasing 4.3% from 2011 and 3.9% from 2010. Pet owners' willingness to pay for high cost veterinary care is increasing the demand for more complex health tests, including diagnostics tests previously used on humans.

Many veterinary clinics offer in-office laboratory tests, but in-office tests are often costly and require the purchase or lease of equipment, maintenance of equipment, and trained technicians. IDEXX Laboratories, the veterinary testing laboratory with the largest share of industry revenue, estimates that half of all diagnostic veterinary lab testing is outsourced to third party labs.

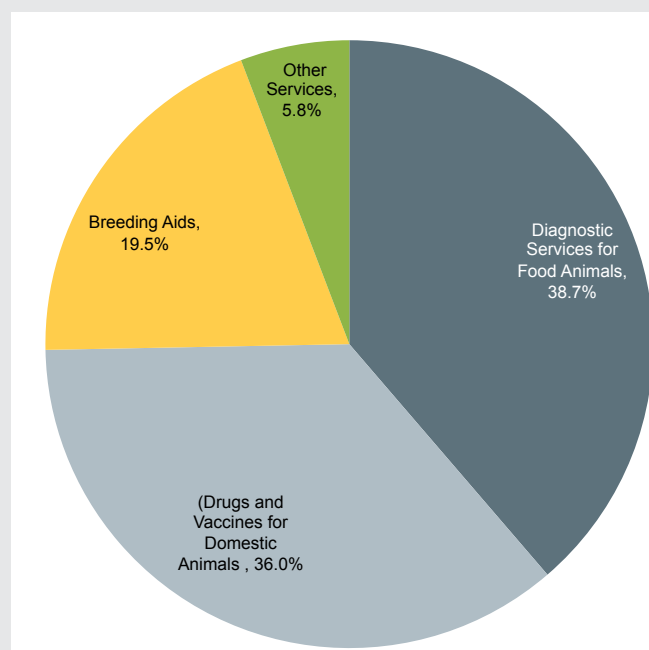
Biotechnology

Animal health biotechnology researches, develops, and tests therapeutic drugs and develops vaccinations for companion animals and livestock. Biotechnology helps diagnose, treat, and prevent costly diseases. According to the US Animal Health Association, livestock diseases alone cost approximately \$1 billion annually. The animal biotech industry generated \$7.2 billion in revenues in 2012, which is an annualized increase of 3.6% and 4.4% from 2011 and 2010, respectively.

Technological advancements have allowed for better health of livestock. Utilizing recent developments, Smithfield is now able to breed genetically leaner hogs and pigs for specialty cuts of meat. Poultry farmers have increased the size of their birds by using antibiotics which kill growth-slowing bacteria. Technological innovation in somatic cell nuclear transfer has led to the cloning of farm and lab animals. The bovine genome, sequenced in 2009 by 300 scientists from 25 countries, will allow scientists to identify disease resistant cattle. Additionally, steps to analyze meat quality through genomics are being made.

There is currently uncertainty surrounding future of animal biotechnology, which will be largely affected by government regulation and public opinion. Although the FDA said that Aquabounty's genetically engineered salmon was safe for human consumption in February 2012, Aquabounty is still waiting for approval as the FDA decides whether it will allow genetically engineered salmon to be a food product.

Biotech Revenue



Source: IBIS Biotech Industry Report

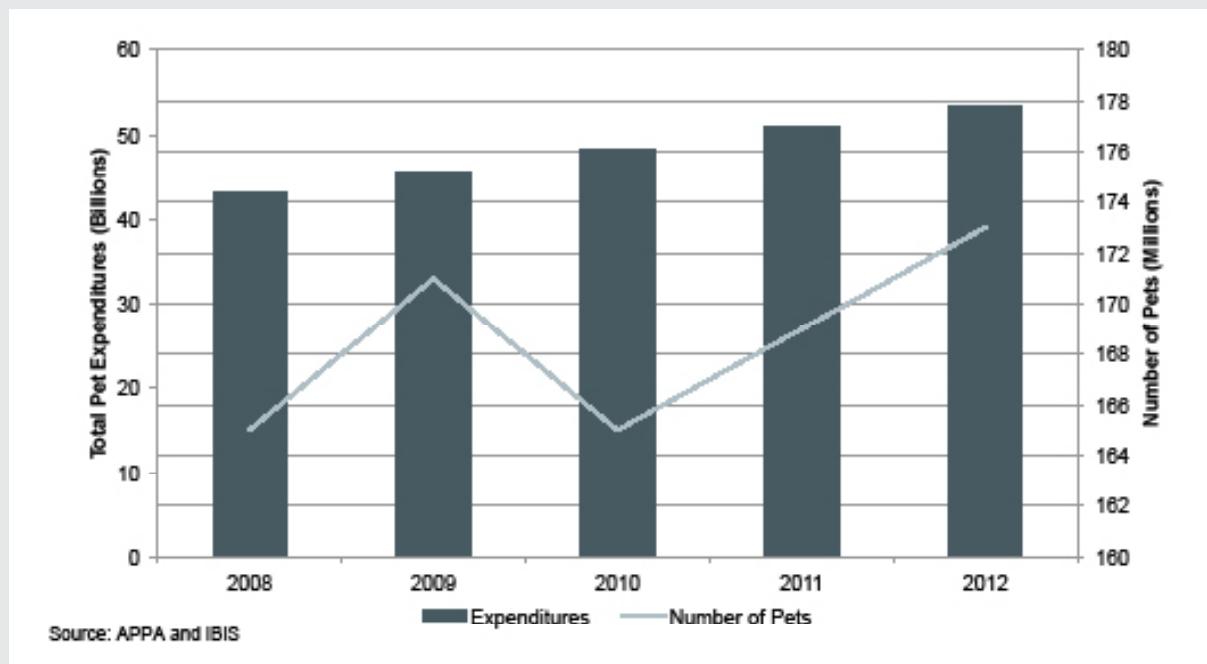
Demand Determinants

The number of companion pets and food animals impacts the demand for animal pharmacology and biotechnology. The number of pets increased by 2.4% in 2012. It is currently estimated that 82.5 million households own at least one pet.

Meat production has been increasing over the last five years. The demand for meat impacts the number of food animals in the US. When meat consumption rises, farmers' revenues increase and farmers have more disposable income to spend on vaccinations and pharmaceuticals for their livestock. Due to a large number of disease outbreaks in livestock herds, health services for livestock are expected to grow. As health consciousness increases, concern for the health and treatment of feed animals should increase the need for health support for feed animals.

The amount of money spent on companion animals and food animals impacts the pharmaceutical and biotechnological industry. APPA estimates that \$53.33 billion was spent on pets in the United States in 2012, which represents a 5.4% increase from 2008. Pet related expenditures are partially driven by the level of disposable income, which increased over the third quarter 2013. Additionally, it is estimated that only 3% of dog owners and 1% of cat owners have pet insurance. As the number of pets covered by pet insurance increase, spending on pharmaceutical is expected to increase as most pet insurance covers prescription medication.

Number of Pets and Pet Expenditures



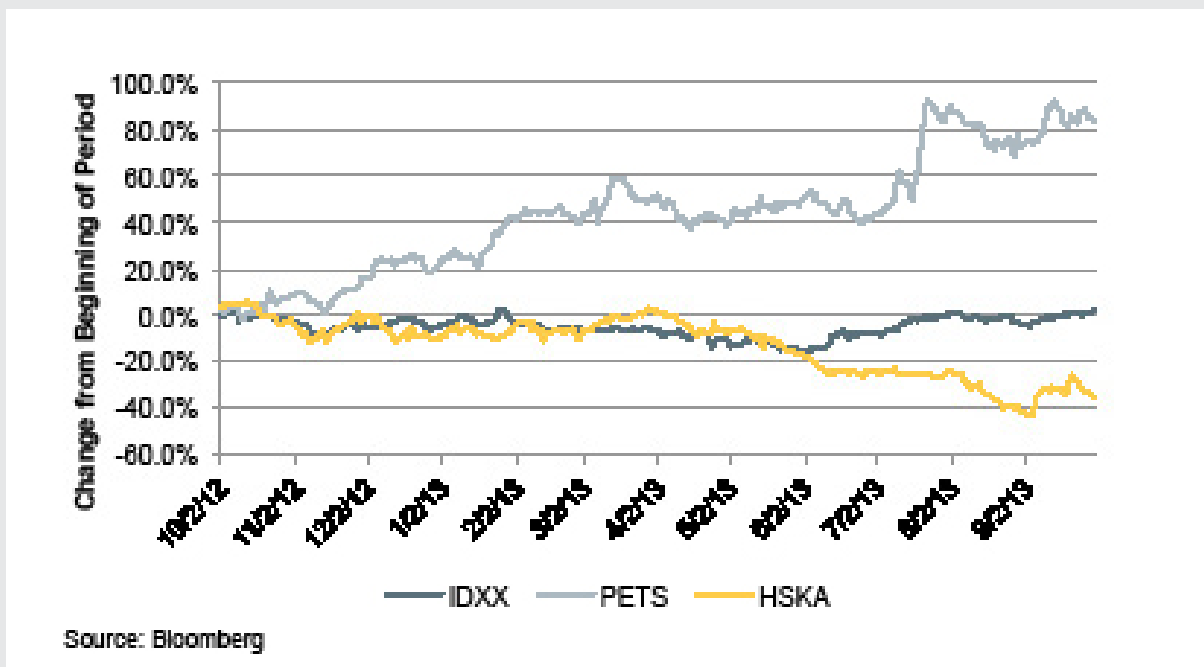
Equity Market Overview

Notable players in the animal health pharmaceutical and biotechnology industry include Heska Corporation, Idexx Laboratories, PetMed Express, Zoetis, and Aratana Therapeutics. Heska (HSKA) Corporation develops, manufactures, and sells veterinary pharmaceuticals and diagnostic tests. Heska experienced a weak third quarter with its price ending at \$5.80. Its price fell nearly 16% during the third quarter and 36% during the past twelve months, likely driven by its majority purchase of Cuattro Veterinary USA and subsequent suspension of dividends. IDEXX Laboratories (IDXX) provides point-of-care veterinary diagnostic products, as well as diagnostic and consulting services for companion and food animals. IDEXX's share price was up 11.1% from the previous quarter end but only experienced an increase of 2.0% over the last twelve months. PetMed Express (PETS) is America's largest pet pharmacy. The company distributes prescription and nonprescription drugs to retail clients nationwide. PetMed experienced a strong quarter with its

share price ending at \$15.68, an increase of 30.6% and 84.3% over the last quarter and last twelve months, respectively.

There have been two major IPOs in the animal pharmaceutical and biotech industry since the start of 2013. Zoetis Inc. (ZTS), a seller of livestock and companion animal drugs and services, is a former subsidiary of Pfizer that was spun off in an IPO at the end of January. The IPO raised \$2.2 billion and was the largest IPO deal since Facebook's May 2012 offering. In May, Pfizer, which retained 80% ownership of Zoetis, offered to exchange its own shares for discounted shares of Zoetis in an effort to spin Zoetis off to its shareholders. Aratana Therapeutics (PETX), which seeks to develop pet medications based on human medications, raised \$39.7 million in its June 2013 IPO. Although its first products are pending regulatory approval and are not expected to launch until 2016, Aratana's stock price rose 170% between the IPO and the end of the quarter.

Pharma/Biotech LTM Historic Stock Prices



Trends in EBITDA

	4Q 2012	1Q 2013	2Q 2013	3Q 2013
VCA Inc (WOOF)	8.26	9.03	9.52	9.12
MWI Vet Supply (MWIV)	14.50	17.32	15.81	17.49
PetMED Express (PETS)	6.49	8.19	7.82	9.40
Heska (HSKA)	7.84	9.89	15.50	-
Zoetis (ZTS)	-	18.97	19.74	20.85
Pet Smart (PETM)	9.02	7.37	7.97	8.85
IDEXX Laboratories (IDXX)	16.08	15.94	15.44	16.58

Source: Bloomberg

M&A Activity

Mergers and acquisitions in the pharmaceutical and biotechnology industry generally reflect consolidations of larger firms with access to a vast R&D network and smaller firms with specific patents or drugs. This trend has been evident in the last twelve months. This consolidation is expected to continue through at least the next five years, resulting in potential cost efficiencies that may increase profits at the surviving companies.

During the first quarter of 2013, Perrigo Company bought Velcera Inc, from multiple private equity firms for a total consideration of \$160 million, although no pricing information was available.

Sector Outlook

The economic growth outlook for the animal health biotech industry is positive. The increasing number of pets and rising pet-related expenditure show the rising demand for companion animal biotech products. Increasing demand for products and technology to treat companion animals, which are increasingly being considered full members of the family, will prompt investment in the industry.

Biotech companies rely heavily on research and development. Continuing economic recovery could cause some companies to increase R&D investment; however, increasing investor uncertainty could harm investment in the industry. Evidence indicates that future growth of the industry will primarily be driven by increased

testing of companion animals. New labs are expected to open in animal hospitals and the industry will see a trend to outsourcing of specialty lab tests. The impact of governmental actions (including regulations, funding grant, and local tax laws) can have significant impacts on the industry.

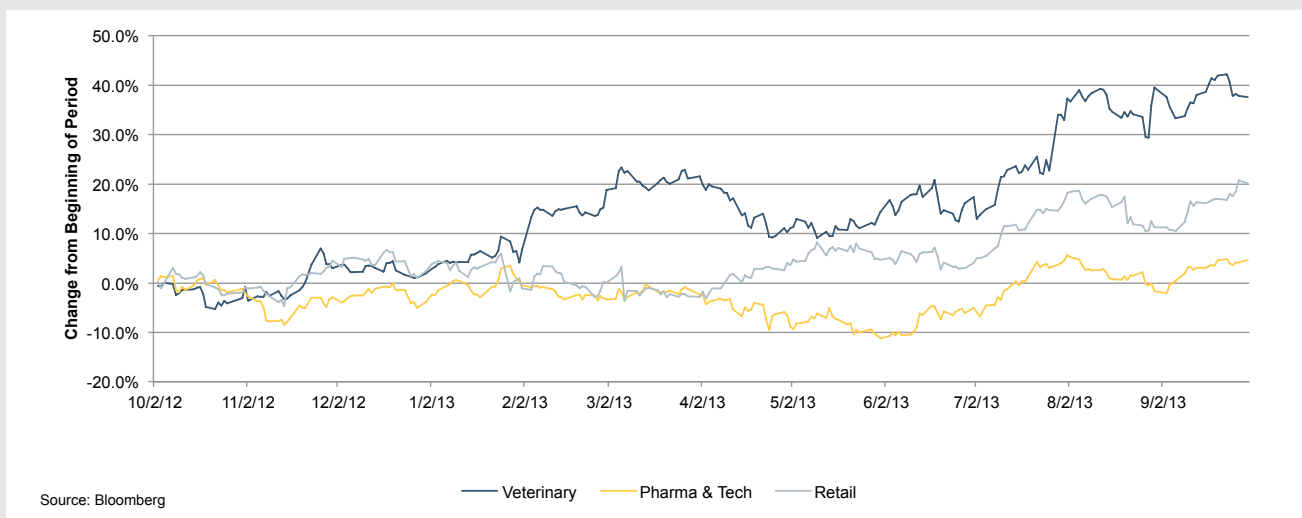
Growth in livestock herds will also drive future animal biotech demand. Meat consumption has been increasing alongside global population growth, and demand for dairy products has risen worldwide. In the future, biotech companies will focus more on genetically engineering meat to produce nutrient-rich products.

Publicly Traded Animal Health Companies

Company Name	Ticker	Sept. 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	27.46	39.2%	88.95	8,445.59	20.6%	18.0%	9.56	8.95	46.54
MWI Veterinary Supply, inc.	MWIV	149.36	38.5%	12.85	3,074.89	1.0%	4.7%	17.56	15.10	30.17
Median-Veterinary Services		88.41	38.8%	50.90	5,760.24	10.8%	11.4%	13.56	12.02	38.36
Pet Retail										
PetSmart Inc	PETM	76.26	12.9%	6,925.27	8,445.59	6.1%	13.31%	9.17	9.19	19.76
PetMed Express Inc	PETS	16.28	61.5%	235.40	328.70	0.0%	12.53%	11.14	11.32	17.89
Median-Pet Retail		46.27	37.2%	3,580.34	4,387.14	3.1%	12.9%	10.15	10.25	18.82
Animal Pharmaceuticals and Biotech										
Heska Corp	HSKA	5.80	-35.7%	73.29	38.76	12.7%	-0.07%	nm	5.70	nm
Zoetis Inc	ZTS	31.12	nm	4,483.00	19,212.00	19.0%	20.17%	21.25	14.12	39.90
IDEXX Laboratories Inc	IDXX	99.65	2.0%	1,342.52	5,577.65	7.2%	24.13%	17.22	16.10	28.97
Abaxis Inc	ABAX	42.12	11.2%	188.77	940.64	0.1%	18.37%	27.12	33.12	50.14
Aratana Therapeutics Inc	PETX	16.34	nm	na	351.44	1.4%	nm	nm	nm	nm
PetMed Express Inc	PETS	16.28	61.5%	235.40	328.70	0.0%	12.53%	11.14	11.32	17.89
Median-Animal		23.73	6.6%	235.40	646.04	4.3%	18.4%	19.24	14.12	34.43

Source: Bloomberg

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



Source: Bloomberg

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:

- 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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