

VALUE FOCUS

Animal Health Industry



2014

Q1: Veterinary Services

Q2: Retail & Pet Services

Q3: Veterinary Services

Q4: Pharmaceutical & Biotechnology

Segment Focus

Veterinary Services

2014 First Quarter

General Overview

Veterinary services are the largest generator of revenue in the pet industry. Veterinary Services generated \$33 billion in revenue in 2013, increasing 4.8% and 2.8% from 2011 and 2012, respectively. 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-fledged members of the family. As the trend of “pet parenthood” continues, a larger variety of specialty services have been introduced to ensure the health and happiness of pets.

General Veterinary Practices

Price increases have been the key driver behind increasing revenue in general veterinary services. 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 diabetes, and the rise of pet store clinics have further reduced demand for veterinary services. Vet practices can now expect a trend toward more of their revenue being 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 again in 2013. Emergency veterinary services generated \$4.8 billion of revenue in 2013, increasing 1.8% over 2012.

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. 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. 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.

In January 2014, the Veterinary Medicine Mobility Act was passed by the Senate. The bill, which is expected to be reviewed by the House in the summer of 2014, would allow veterinarians to carry medications from their clinics to remote sites, including across state lines. In addition to expanding the territory in which rural large animal vets can operate, the bill would also effectively allow practitioners to provide pain management and end of life care for companion animals at home.

Demand Determinants

VCA (“WOOF”) operates 612 animal hospitals in the United States which provide general medical services, surgical services, and specialty services. VCA also has 59 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 veterinary labs in the US.

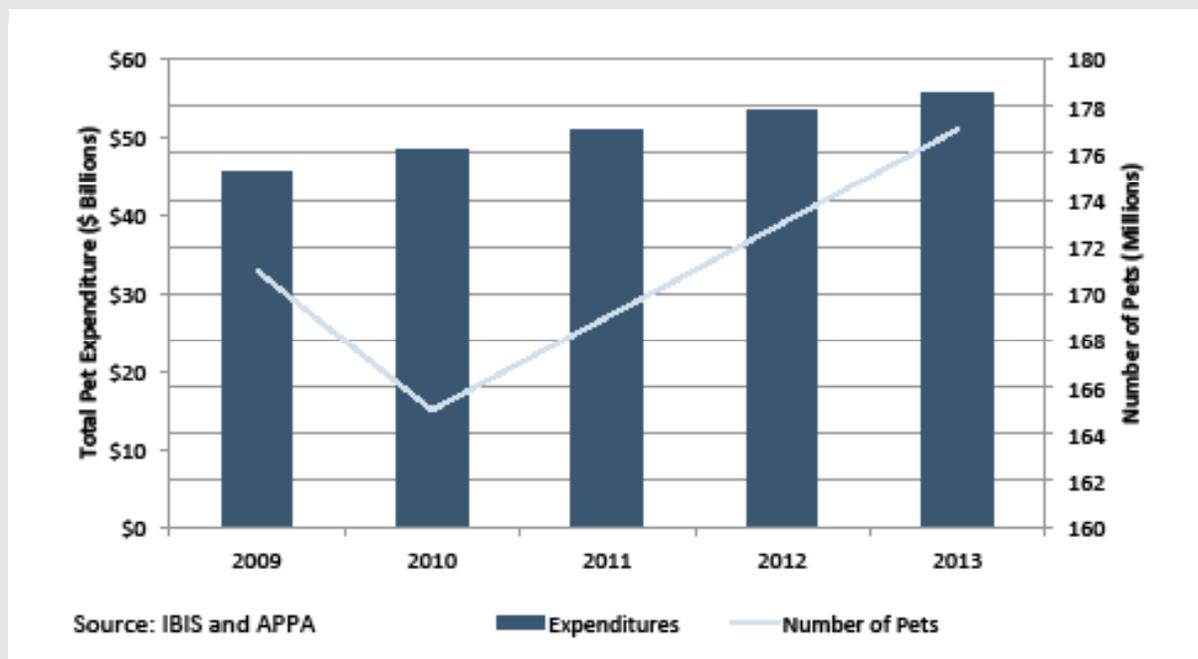
Although it does not provide veterinary services, MWI Veterinary Supply (“MWIV”) provides products to animal hospitals ranging from dental x-ray equipment to vaccinations and animal food. Demand of MWI’s products depends strongly on the strength of the veterinary services market.

VCA’s share price, which ended the third quarter at \$35.09, posted total gains of 8.9% and 31.9% over the quarter and year, respectively. VCA’s price gains were driven by revenue growth, which was itself largely driven through acquisitions (VCA acquired \$28.1 million in animal hospital revenue year to date through June 2014). Same-store revenue growth in its animal health segment grew 1.4% in the

six months ending June 30, 2014 relative to the six months ending June 30, 2013. Same-store revenue growth is attributable to 2.8% increase in average revenue per order outstripping the 1.4% decline in number of orders.

MWI’s share price declined 8.7% over the quarter but increased 14.3% over the last year. MWI’s acquisition of IVESCO (a distributor and retailer of animal health products and services) boosted its price well into the first quarter. MWI paid \$78.7 million for \$154.3 million in assets. Following the first quarter, MWI has experienced increasing revenues and a modest decrease in both gross and net margins. Increasing price pressure from competitors and the success of lower-margin INVSECO products has impacted MWI’s margins. MWI was also severely impacted by severe weather conditions in the first quarter of 2014. Overall, however, MWI’s earnings per share increased in the last nine months, relative to the nine month period ending June 30, 2013. A negative revision and lower consensus outlooks led to a steep decline in the stock price in early May, although the price has been largely recovering throughout the second and third quarters.

Number of Pets and Pet Expenditures



Equity Market Overview

VCA Antech, Inc ("WOOF") is the dominant provider of veterinary services in the company and 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 veterinary labs in the US.

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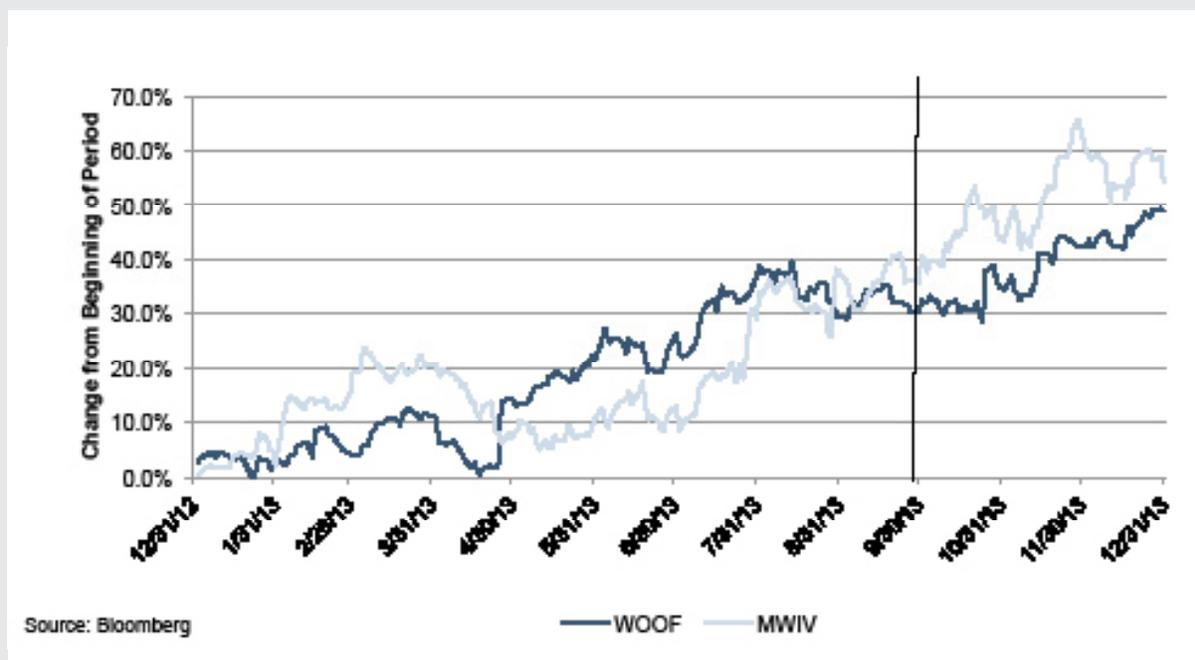
VCA's share price, which ended the fourth quarter at \$31.36, posted total gains of 14.2% and 49.0% over the quarter and year, respectively. VCA's price gains were driven by strong revenue growth (7% increase year over year) and positive margin performance. Same-store revenue growth in its animal health segment grew roughly 1%

(comparable to growth between 2011 and 2012). Despite its relatively slow same-store animal health revenue growth, VCA experienced a 7% increase in animal health same-store gross profit. Same-store laboratory revenue experienced 7% growth.

MWI also experienced strong share price growth during the last quarter of 2013. Overall, MWI's share price increase 13.8% and 54.5% over the quarter and the year, respectively. A large portion of MWI's price increase was driven by its November 2013 acquisition of IVESCO, a distributor and retailer of animal health products and services. MWI's paid \$78.7 million for \$154.3 million in assets. IVESCO's assets generated 11% of MWI's income for the quarter.

Both VCA and MWI have experienced a trend of increasing EBITDA multiple during the last four quarters. VCA's improved profitability (VCA's net income margin increased to 13.8% in 2013 from 5.5% in 2012) contributed to its improving multiple. MWI's expanded EBITDA multiple is largely a factor of increased revenue from the INVESCO purchase, as the Company's overall net income margin has been relatively stable throughout the last four quarters.

Veterinary LTM Historic Stock Prices



Trends in EBITDA

	1Q 2013	2Q 2013	3Q 2013	4Q 2013
VCA Inc (WOOF)	9.03	9.52	9.12	10.03
MWI Vet Supply (MWIV)	17.32	15.81	17.49	20.13
PetMED Express (PETS)	8.19	7.82	9.40	10.05
Heska (HSKA)	9.89	15.50	-	59.84
Zoetis (ZTS)	18.97	19.74	20.85	19.36
Pet Smart (PETM)	7.37	7.97	8.85	8.32
IDEXX Laboratories (IDXX)	15.94	15.44	16.58	17.64

Source: Bloomberg

M&A Activity

Recently the veterinary services sector has seen trends of consolidation. VCA estimates that there are over 26,000 companion animal hospitals, with most operating with a sole-practitioner. 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. The most attractive targets offer consistent work hours and an increased client base. No-lo practices (vet practices with no or low revenues) can enable

buyers to expand practice size despite the low margins of the acquired office. Many buyers become the main practitioner of the consolidated practice.

It was reported in February 2014 that National Veterinary Associates (NVA), the largest privately-held system of veterinary hospitals in the US, was seeking a sale of the Company. According to Reuters, NVA, which owns 225 animal hospitals in 39 states, reported EBITDA of approximately \$60 million in 2013 and was rumored to be valued at a multiple between 10x and 11x EBITDA, implying a total valuation of approximately \$700 million. Presumably, this range of multiples assumes a baseline market multiple in line with VCA (approximately 10x) with some additional strategic or synergistic premium. Both assumptions are likely to be optimistic versus actual market value for NVA

Sector Outlook

The veterinary industry faces competition from retail stores such as Pet Smart, which operated full service veterinary hospitals in 839 of its 1,314 storefronts as of November 2013. Additionally, some pet stores are offering in store vaccinations. As traditional vets expand

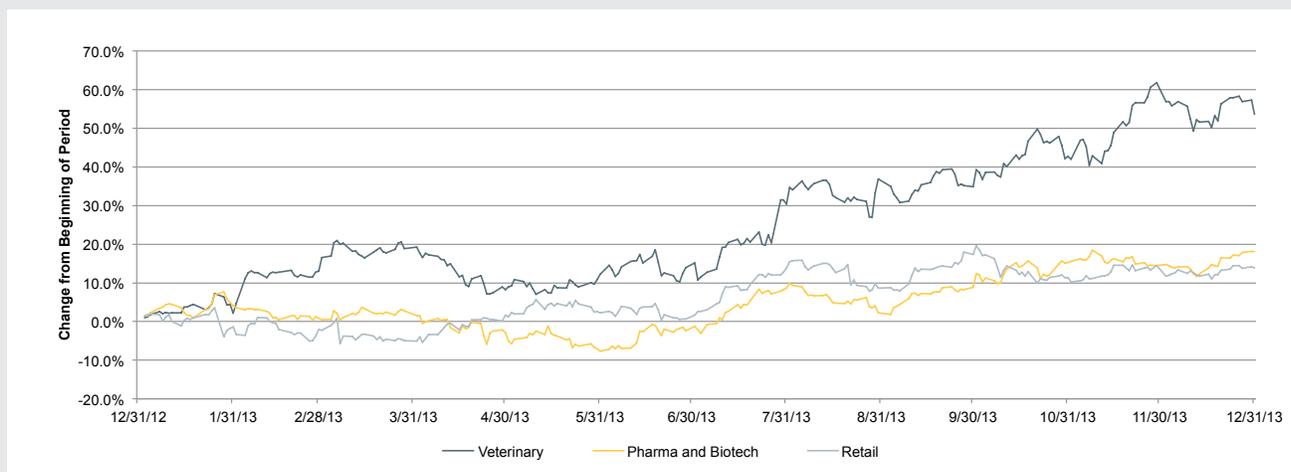
their practices to compete with in store clinics, emergency vets will face increased competition, since increasing use of preventative measures should decrease demand for emergency care.

Publicly Traded Animal Health Companies

Company Name	Ticker	Dec. 31 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	31.36	49.0%	88.51	8,338.80	18.3%	18.2%	10.32	9.10	20.50
MWI Veterinary Supply, inc.	MWIV	169.97	54.5%	12.85	3,395.26	4.8%	4.6%	20.14	15.77	33.46
Median-Veterinary Services		100.66	51.7%	50.68	5,867.03	11.5%	11.4%	15.23	12.43	26.98
Pet Retail										
PetSmart Inc	PETM	72.75	6.5%	6,990.93	8,338.80	6.2%	13.36%	8.93	8.80	18.23
PetMed Express Inc	PETS	16.63	49.8%	235.88	335.77	0.0%	12.42%	11.46	11.29	18.27
Median-Pet Retail		44.69	28.1%	3,613.40	4,337.28	3.1%	12.9%	10.20	10.05	18.25
Animal Pharmaceuticals and Biotech										
Heska Corp	HSKA	8.72	7.7%	78.34	56.28	9.4%	1.36%	52.74	5.70	nm
Zoetis Inc	ZTS	32.69	nm	4,561.00	20,002.00	18.3%	21.99%	19.94	13.35	32.37
IDEXX Laboratories Inc	IDXX	106.37	14.6%	1,377.06	5,910.60	7.2%	23.34%	18.39	15.08	30.57
Abaxis Inc	ABAX	40.01	7.8%	179.78	890.67	0.1%	17.74%	27.92	22.68	52.65
Aratana Therapeutics Inc	PETX	19.10	nm	0.12	465.36	3.9%	nm	nm	nm	nm
PetMed Express Inc	PETS	16.63	49.8%	235.88	335.77	0.0%	12.42%	11.46	11.29	18.27
Median-Animal		25.90	11.2%	207.83	678.02	5.6%	17.7%	19.94	13.35	31.47

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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