

# VALUE FOCUS

## Animal Health Industry



### SEGMENT FOCUS

## Veterinary Care

## 2015

#### Veterinary Care

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#### Animal Health Industry

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Q1: Veterinary Care

Q2: Retail & Pet Services

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& Biotechnology

## Industry Overview

As of December 2014, an estimated 65,000 veterinarians were involved in private practice in the United States. Demand for veterinary services has been spurred by growing numbers of households with companion animals, aging pets, and the growing trend of “pet parenthood.” Advances in animal healthcare have allowed specialty practices to expand over the last several decades and the increasing knowledge of and availability of pet insurance has increased demand for otherwise cost-prohibitive services.

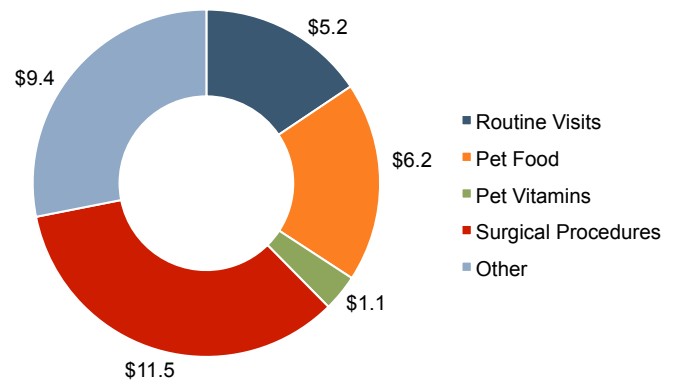
In 2014, pet owners spent just over \$15 billion on veterinary services, and are expected to spend \$15.7 billion in 2015. Pet ownership is the main driver of veterinary services and has grown at an annualized rate of 2.3% in the five year period ending in 2015. According to the 2015-2016 APPA National Pet Owners Survey, over 65% of US households own a pet. Rising income and falling unemployment are expected to lead to continued growth in the number of pets.

The breakdown of veterinary service revenue by source is shown in the chart on this page. Preventative care services are expected to grow during the next several years. Increasing specialization (in fields including cardiology, dermatology, oncology, eye care, and endocrinology) and advances in internal medicine for animals are also expected to expand the reach of veterinary services and increase industry revenue. The growth of specialty services in the animal health industry is aided by the continued growth of pet insurance. Although only 3.0% and 1.0% of dog and cats are covered by health insurance, respectively, pet insurance revenue grew at an annualized rate of 21% between 2009 and 2014.

Consolidation trends continue among veterinary practices and suppliers, although concentration in the industry remains low.

### Veterinary Products and Services

(billions)



Source: IbisWorld

There are over 51,000 veterinary services establishments as of April 2015, and the largest 25% generate less than 15% of industry revenue. Nearly 40% of practices were solo practices in 2009 (most recent data available), but many practices are combining or joining larger conglomerates in order to gain cost synergies or expanded market bases. Industry consolidation is a development that is expected to continue.

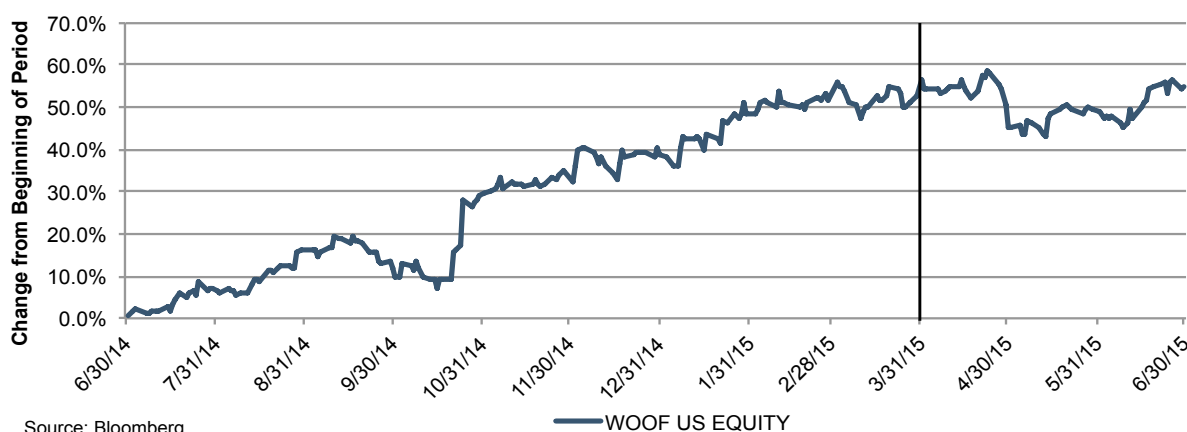
## Equity Market Overview

**VCA Antech, Inc.** ("WOOF") is a major provider of veterinary services and operates 657 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. VCA also sells radiography and ultrasound equipment, publishes various animal health publications, and licenses 127 Camp Bow Wow dog day care franchises. VCA's share price, which ended the second quarter at \$54.41, posted total gains of 1.6% and 55.0% over the quarter and year, respectively. VCA's pricing

gains were driven by ongoing acquisitions and continuing revenue growth, which increased 11.6% in the year-to-date June 30, 2015, period relative to the same period in 2014. Animal hospital same store revenue increased 6.7% in the YTD September 2014 period. In October 2014, VCA's price was boosted by larger than anticipated revenue and gross income gains, which resulted in an upward revision to fiscal 2014's expected performance.

VCA experienced a trend of increasing EBITDA multiple during three of the last four quarters. VCA's improved profitability contributed to its multiple expansion over the past year.

### Veterinary LTM Stock Performance



### Trends in EBITDA Pricing Multiples

	Q3 2014	Q4 2014	Q1 2015	Q2 2015
VCA, Inc. (WOOF)	11.36	13.42	15.01	14.46
PetMed Express (PETS)	13.42	15.01	14.46	17.03
Heska, Inc. (HSKA)	33.08	33.77	33.64	24.73
Zoetis, Inc. (ZTS)	14.17	17.47	26.82	25.61
IDEXX Laboratories (IDXX)	nm	18.15	19.27	20.10
Abaxis, Inc. (ABAX)	18.34	21.82	24.48	20.73
Aratana Therapeutics (PETX)	nm	nm	nm	nm
Parnell Pharmaceuticals (PARN)	nm	nm	16.56	17.08
Phibro Animal Health (PAHC)	nm	nm	nm	nm
Jaguar Animal Health (JAGX)	nm	nm	nm	nm
Kindred Biosciences (KIN)	nm	nm	nm	nm

Source: Capital IQ

Presented pricing multiples represent enterprise value relative to EBITDA from the prior twelve months  
EBITDA: Earnings before interest, taxes, depreciation, and amortization

## M&A Activity

Recently the veterinary services sector has seen a trend toward consolidation. 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. The acquisition of vet practices with no or low profitability can enable buyers to expand practice size despite the low margins of the acquired facility. Additionally, specialists will often combine resources, with many specialists (either in the same specialty or across a variety of specialties) merging in order combine market bases or purchasing power.

On March 31, 2015, **VCA** acquired **Abaxis Veterinary Reference Laboratory (AVRL)** from **Abaxis, Inc.** for total consideration of \$21.0 million. Estimates of AVRL's revenue, income, or assets were unavailable. VCA allocated \$15.3 million of the purchase price to customer relationships intangible.

Consolidation has occurred not only within in the industry, but also through business combinations with companies in adjacent industries. On January 12, 2015, **AmerisourceBergen Corp. (ABC)** agreed to purchase **MWI Veterinary** (formerly traded as "MWI"). ABC offered \$190 per share (a 7% premium to the previous day's closing price), resulting in a total purchase price of \$2.5 billion. This purchase price implies a revenue multiple of 0.8x and an EBITDA multiple of 18.5x. ABC cited the growing animal health market as a key influence in its decision to purchase MWI. ABC will also likely experience revenue- and cost-saving-synergies generated by streamlined distribution models and improved purchasing power with suppliers. The deal closed February 23, 2015, earlier than the March close expected by analysts.

## Sector Outlook

The traditional care veterinary industry faces competition from retail stores such as Pet Smart, which are increasingly offering full-service veterinary hospitals in existing storefront. As traditional vets expand their practices to compete with in store clinics, emergency and specialty vets face increasing competition. The improving economy

has increased households' demand for services. While increasing specialization should drive margins higher, competition is expected to provide downward margin pressure. Based on industry report, veterinary services revenue is expected to grow at an annualized rate of 3.2% over the five year period ending in 2020.

**Publicly Traded Animal Health Companies**

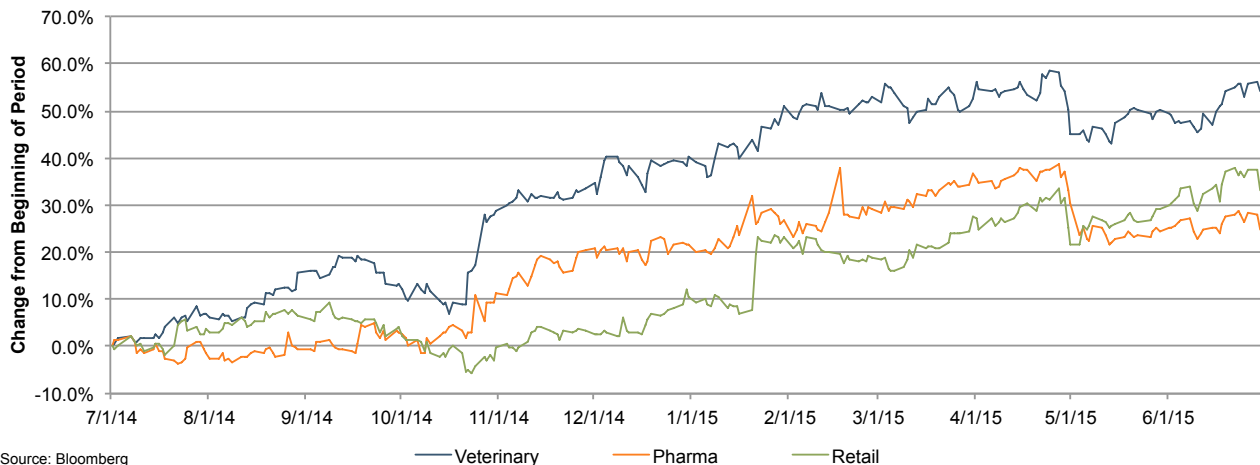
Company Name	Ticker	6/30/15 Price (\$)	52 Wk Perform (%)	Sales (\$)	Enterprise Value (\$M)	Debt/ Mart. Cap	EBITDA Margin	EV/ EBITDA (x)	EV / Next Yr EBITDA (x)	P/E (x)
<b>Veterinary Services</b>										
VCA Inc.	WOOF	54.41	55.0%	82.14	8,763.64	15.1%	17.0%	15.72	12.52	33.79
<b>Pet Retail</b>										
PetMed Express Inc	PETS	17.27	34.3%	229.40	349.94	0.0%	12.33%	12.38	11.44	19.63
<b>Animal Pharmaceuticals and Biotech</b>										
Heska Corp	HSKA	29.69	176.2%	91.94	190.31	1.1%	8.73%	23.72	14.53	64.54
Zoetis Inc	ZTS	48.22	50.6%	4,790.00	27,772.73	13.1%	23.95%	24.21	17.25	40.86
IDEXX Laboratories Inc	IDXX	64.14	-4.0%	1,508.08	7,052.49	14.9%	21.53%	21.72	17.74	35.15
Abaxis Inc	ABAX	51.48	17.1%	212.94	1,160.79	0.0%	19.64%	27.76	23.88	58.50
Aratana Therapeutics Inc	PETX	4.95	-3.1%	6.90	25.81	97.8%	nm	nm	nm	nm
PetMed Express Inc	PETS	17.27	34.3%	229.40	349.94	0.0%	12.33%	12.38	11.44	19.63
Parnell Pharmaceuticals Holdings Ltd	PARN	4.95	-28.3%	6.90	25.81	97.8%	nm	nm	nm	nm
Phibro Animal Health Corp	PAHC	38.94	79.9%	747.34	1,806.17	15.9%	13.59%	17.78	15.31	41.87
Jaguar Animal Health Inc	JAGX	4.82	nm	0.00	21.53	4.2%	nm	nm	nm	nm
Kindred Biosciences Inc	KIN	6.82	-63.4%	0.00	134.52	0.0%	nm	nm	nm	nm
<b>Median- Animal Pharm &amp; Biotech</b>		<b>23.48</b>	<b>17.1%</b>	<b>152.44</b>	<b>270.13</b>	<b>8.7%</b>	<b>16.6%</b>	<b>22.72</b>	<b>16.28</b>	<b>41.37</b>

Source: Bloomberg

Note: Aratana, Parnell, Jaguar, and Kindred current income results in nonmeaningful multiples.

Note: PetSmart and MWI Veterinary no longer included due to acquisitions in the first quarter of 2015.

**Median Percent Change in LTM Stock Prices by Industry Segment**



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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# Erickson Partners

## Merges with Mercer Capital



**Mercer Capital**, a national business valuation and financial advisory firm specializing in Corporate Valuation, Litigation Support, Financial Reporting Valuation, and Transaction Advisory Consulting, and **Erickson Partners, Inc.**, a Texas-based Valuation and Litigation Support firm, announce their merger effective July 1, 2015.

Mercer Capital, with its strong presence throughout the Southeast and Midwest, and Erickson Partners, with its strong presence in Texas and Oklahoma, are a perfect fit.

Both firms maintain the highest standards of quality for financial analysis and client service and believe deeply in hiring and developing the best professionals.

“The culture of both firms is so similar and that was important to us. The professionals of Erickson Partners are well-known in the valuation profession as some of the best and brightest. Their work product and reputation are stellar. This merger not only allows us to broaden our geographic reach but also our industry expertise,” said **Matt Crow**, President of Mercer Capital.

Erickson Partners enhances Mercer Capital’s broad base of industry concentrations with their exceptional history working with and knowledge of professional sports franchises and the energy sector.

“Over our 30 plus year history, Mercer Capital has developed several industry concentrations. By adding the knowledge, insight, and expertise of Don Erickson, Bryce Erickson, and the rest of the professionals of Erickson Partners, we now bring deep experience and insight to a broader range of industries than we could as separate firms,” said **Chris Mercer**, CEO of Mercer Capital.

“Combining with Mercer Capital, we will now be able to offer new or expanded services that complement our existing services, as well as additional industry expertise,” said **Bryce Erickson**, Managing Director of Erickson Partners. “In addition to our sports franchise and energy industry concentrations, we will be able to offer deep industry concentrations in construction and building materials, agribusiness, manufacturing and financial institutions, which includes depository institutions, insurance companies, fintech companies, asset management firms, and PE firms.”

“The combined firm will have over 40 valuation professionals positioned in five markets throughout the southwest and southeast. Such a deep bench will provide us with a tremendous opportunity to better serve the expanding needs of our clients,” said **Don Erickson**, President of Erickson Partners. “Joining with Mercer Capital gives us national resources that will benefit our clients in Texas and beyond.”

### About Mercer Capital

Mercer Capital is a national business valuation and financial advisory firm offering corporate valuation, litigation support, financial reporting valuation, and transaction advisory consulting services to a national client base. Clients include private and public operating companies, financial institutions, asset holding companies, high-net worth families, and private equity/hedge funds.

### About Erickson Partners, Inc.

Erickson Partners is a professional valuation and advisory firm specializing in business valuation, litigation support, financial investigations and strategic corporate advisory services. Founded by Don & Bryce Erickson, Erickson Partners has served large and small clients by providing complex financial and economic analysis, leading to reasonable valuation opinions that withstand scrutiny.

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