VCA ANTECH INC
Form 10-Q
November 07, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2007

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________
Commission File Number: 001-16783

VCA Antech, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**95-4097995**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

12401 West Olympic Boulevard
Los Angeles, California 90064-1022
(Address of principal executive offices)
(310) 571-6500
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o.
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer þ Accelerated filer o Non-accelerated filer o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ.
Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: common stock, $0.001 par value 84,253,313 shares as of November 6, 2007.

VCA Antech, Inc.
Form 10-Q
September 30, 2007
Table of Contents

	Page Number
Part I. Financial Information	
Item 1. Financial Statements (Unaudited)	
Condensed, Consolidated Balance Sheets as of September 30, 2007 and December 31, 2006	1
Condensed, Consolidated Income Statements for the Three and Nine Months Ended September 30, 2007 and 2006	2
Condensed, Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2007 and 2006	3
Notes to Condensed, Consolidated Financial Statements	4
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3. Quantitative and Qualitative Disclosures About Market Risk	26
Item 4. Controls and Procedures	26
Part II. Other Information	
Item 1. Legal Proceedings	27
Item 1A. Risk Factors	27
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	27
Item 3. Defaults Upon Senior Securities	27
Item 4. Submission of Matters to a Vote of Security Holders	27
Item 5. Other Information	27
Item 6. Exhibits	27
Signature	28
Exhibit Index	29
EXHIBIT 31.1	
EXHIBIT 31.2	
EXHIBIT 32.1	

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VCA Antech, Inc. and Subsidiaries
Condensed, Consolidated Balance Sheets
(Unaudited)
(In thousands, except par value)

	September 30, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 87,155	$ 45,104
Trade accounts receivable, less allowance for uncollectible accounts of $11,297 and $11,195 at September 30, 2007 and December 31, 2006, respectively	46,503	44,491
Inventory	21,332	21,420
Prepaid expenses and other	13,616	13,492
Deferred income taxes	17,866	14,935
Prepaid income taxes		13,523
Total current assets	186,472	152,965
Property and equipment, less accumulated depreciation and amortization of $126,894 and $111,165 at September 30, 2007 and December 31, 2006, respectively	206,347	166,033
Goodwill	847,942	625,748
Other intangible assets, net	16,586	16,293
Notes receivable, net	2,897	2,675
Deferred financing costs, net	1,623	979
Other	11,278	7,264
Total assets	$ 1,273,145	$ 971,957
Liabilities and Stockholders Equity		
Current liabilities:		
Current portion of long-term obligations	$ 7,997	$ 6,648
Accounts payable	23,905	23,328
Accrued payroll and related liabilities	32,932	33,864
Accrued interest	608	388
Other accrued liabilities	43,353	30,573
Total current liabilities	108,795	94,801
Long-term obligations, less current portion	554,205	384,067
Deferred income taxes	45,647	39,804
Other liabilities	12,118	13,294
Minority interest	10,634	9,686
Commitments and contingencies		
Preferred stock, par value $0.001, 11,000 shares authorized, none outstanding		
Stockholders equity:		

Common stock, par value $0.001, 175,000 shares authorized, 84,210 and 83,560 shares outstanding as of September 30, 2007 and December 31, 2006, respectively		84		84
Additional paid-in capital		292,223		275,013
Accumulated earnings		250,975		154,586
Accumulated other comprehensive (loss) income		(1,536)		622
Total stockholders equity		541,746		430,305
Total liabilities and stockholders equity	$	1,273,145	$	971,957

The accompanying notes are an integral part of these condensed, consolidated financial statements.

1

Table of Contents

VCA Antech, Inc. and Subsidiaries
Condensed, Consolidated Income Statements
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Revenue	$ 306,537	$ 251,632	$ 871,987	$ 740,962
Direct costs	220,235	181,167	619,887	532,014
Gross profit	86,302	70,465	252,100	208,948
Selling, general and administrative expense	22,295	18,946	65,811	57,315
Loss (gain) on sale of assets	333	3	875	(200)
Operating income	63,674	51,516	185,414	151,833
Interest expense, net	8,930	6,084	21,374	18,323
Other (income) expense	(1)	73	226	(24)
Minority interest in income of subsidiaries	1,187	846	3,061	2,520
Income before provision for income taxes	53,558	44,513	160,753	131,014
Provision for income taxes	21,329	17,536	64,364	44,825
Net income	$ 32,229	$ 26,977	$ 96,389	$ 86,189
Basic earnings per share	$ 0.38	$ 0.32	$ 1.15	$ 1.04
Diluted earnings per share	$ 0.38	$ 0.32	$ 1.13	$ 1.02
Weighted-average shares outstanding for basic earnings per share	83,957	83,339	83,769	83,092
Weighted-average shares outstanding for diluted earnings per share	85,752	85,187	85,572	84,864

The accompanying notes are an integral part of these condensed, consolidated financial statements.

Table of Contents

VCA Antech, Inc. and Subsidiaries
Condensed, Consolidated Statements Of Cash Flows
(Unaudited)
(In thousands)

	Nine Months Ended September 30,	
	2007	**2006**
Cash flows from operating activities:		
Net income	$ 96,389	$ 86,189
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19,764	16,347
Amortization of debt costs	253	299
Provision for uncollectible accounts	3,561	4,174
Loss (gain) on sale of assets	875	(200)
Share-based compensation	3,429	2,326
Minority interest in income of subsidiaries	3,061	2,520
Distributions to minority interest partners	(2,262)	(2,439)
Deferred income taxes	4,627	7,222
Excess tax benefit from exercise of stock options	(6,576)	(5,774)
Other	(115)	(750)
Changes in operating assets and liabilities:		
Accounts receivable	(4,823)	(8,500)
Inventory, prepaid expenses and other assets	1,140	(6,816)
Accounts payable and other accrued liabilities	(1,195)	(2,499)
Accrued payroll and related liabilities	(3,958)	(1,928)
Income taxes	20,983	567
Net cash provided by operating activities	135,153	90,738
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(214,758)	(37,612)
Real estate acquired in connection with business acquisitions	(7,962)	(2,872)
Property and equipment additions	(38,033)	(23,800)
Proceeds from sale of assets	1,774	533
Other	(188)	268
Net cash used in investing activities	(259,167)	(63,483)
Cash flows from financing activities:		
Repayment of long-term obligations	(6,282)	(64,106)
Proceeds from the issuance of long-term obligations	160,000	
Payment of financing costs	(897)	
Proceeds from issuance of common stock under stock option plans	6,668	5,410
Excess tax benefit from exercise of stock options	6,576	5,774
Net cash provided by (used in) financing activities	166,065	(52,922)
Increase (decrease) in cash and cash equivalents	42,051	(25,667)

Cash and cash equivalents at beginning of period	45,104	58,488
Cash and cash equivalents at end of period	$ 87,155	$ 32,821

The accompanying notes are an integral part of these condensed, consolidated financial statements.

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes To Condensed, Consolidated Financial Statements
September 30, 2007
(Unaudited)

1. Nature of Operations

Our company, VCA Antech, Inc. (VCA) is a Delaware corporation formed in 1986 and is based in Los Angeles, California. We are an animal healthcare company with three strategic segments: veterinary diagnostic laboratories (Laboratory), animal hospitals (Animal Hospital) and veterinary medical technology (Medical Technology).

We operate a full-service veterinary diagnostic laboratory network serving all 50 states. Our laboratory network provides sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. At September 30, 2007, we operated 35 laboratories of various sizes located strategically throughout the United States.

Our animal hospitals offer a full range of general medical and surgical services for companion animals. Our animal hospitals treat diseases and injuries, provide pharmaceutical products and perform a variety of pet-wellness programs, including health examinations, diagnostic testing, vaccinations, spaying, neutering and dental care. At September 30, 2007, we operated 441 animal hospitals throughout 38 states.

Our medical technology segment sells digital radiography and ultrasound imaging equipment, provides education and training on the use of that equipment, and provides consulting and mobile imaging services.

2. Basis of Presentation

Our accompanying unaudited, condensed, consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) in the United States for interim financial information and in accordance with the rules and regulations of the United States Securities and Exchange Commission. Accordingly, they do not include all of the information and notes required by GAAP in the United States for annual financial statements as permitted under applicable rules and regulations. In the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included. The results of operations for the three and nine months ended September 30, 2007, are not necessarily indicative of the results to be expected for the full year ending December 31, 2007. For further information, refer to our consolidated financial statements and notes thereto included in our 2006 Annual Report on Form 10-K.

The preparation of our condensed, consolidated financial statements in accordance with GAAP in the United States requires management to make estimates and assumptions that affect the amounts reported in our condensed, consolidated financial statements and notes thereto. Actual results could differ from those estimates.

3. Acquisitions

We acquired the following animal hospitals during the nine months ended September 30, 2007:

Hospital acquisitions, excluding Healthy Pet (1)	29
Healthy Pet (1)	44
Acquisitions relocated into our existing animal hospitals	(7)
Total	66

(1) Healthy Pet Corp. (Healthy Pet) was acquired on June 1, 2007.

We acquired two laboratories during the nine months ended September 30, 2007, one of which was acquired with Healthy Pet and was merged into our existing operations.

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes To Condensed, Consolidated Financial Statements (Continued)

3. Acquisitions, continued

Animal Hospital and Laboratory Acquisitions, Excluding Healthy Pet

The following table summarizes the preliminary purchase price, including acquisition costs, paid by us for the 29 animal hospitals and one laboratory we acquired during the nine months ended September 30, 2007, and the preliminary allocation of the purchase price (in thousands):

Preliminary Purchase Price:	
Cash	$ 57,990
Liabilities assumed	2,755
Total	$ 60,745
Preliminary Allocation of the Purchase Price:	
Tangible assets	$ 2,662
Identifiable intangible assets	2,906
Goodwill (1)	55,177
Total	$ 60,745

(1) We expect that $45.7 million of the goodwill recorded for these acquisitions as of September 30, 2007 will be deductible for income tax purposes.

Healthy Pet

On June 1, 2007, we acquired Healthy Pet, which operated at the time of its acquisition, 44 animal hospitals and a small laboratory, which primarily serviced its own animal hospitals. This acquisition allowed us to expand our animal hospital operations, particularly in Massachusetts, Connecticut, Virginia and Georgia. Our condensed, consolidated financial statements reflect the operating results of Healthy Pet since June 1, 2007.

We acquired Healthy Pet for a preliminary purchase price of $184.7 million. The following table summarizes the preliminary purchase price and the preliminary allocation of the purchase price (in thousands):

Preliminary Purchase Price:	
Cash paid to holders of Healthy Pet stock and debt, net of cash acquired	$ 153,568
Cash paid for professional services	1,216
Debt and capital leases assumed	17,761
Liabilities assumed	8,708
Liabilities for our plan to eliminate duplicate functions and to close certain animal hospitals	3,432

Total	$ 184,685

Preliminary Allocation of the Purchase Price:	
Tangible assets	$ 15,110
Identifiable intangible assets	383
Goodwill (1)	169,192
Total	$ 184,685

(1) As of September 30, 2007, we have not finalized the determination of the amount of goodwill that will be deductible for income tax purposes.

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes To Condensed, Consolidated Financial Statements (Continued)

3. Acquisitions, continued

The final purchase price and the valuation of the net assets acquired is expected to be completed as soon as practicable, but no later than one year from the date of acquisition. The final calculation of the purchase price, which is based on Healthy Pet s working capital at June 1, 2007, is currently pending review by an independent accounting firm. In addition, given the relative size and complexity of the acquisition, the fair value of certain assets and liabilities acquired, primarily fixed and intangible assets, lease obligations, the 2007 tax liability and deferred tax balances, is still preliminary. We have engaged various third-parties to provide valuation expertise where necessary and have not yet received their completed analyses. With respect to lease obligations, we are currently engaged in negotiating the termination of certain contracts. Also, we have not received final billings related to professional services used in the acquisition as the service provider has not completed its billing process or the work has not yet been completed.

Other Acquisition Payments

In connection with certain acquisitions, we withheld a portion of the purchase price (holdback) as security for indemnification obligations of the sellers under the acquisition agreement. We paid $1.2 million to sellers for the unused portion of the holdbacks during the nine months ended September 30, 2007.

During the nine months ended September 30, 2007, we paid $745,000 to purchase the ownership interest in two partially-owned subsidiaries.

4. Long-Term Obligations and Interest Rate Swap Agreements

On June 1, 2007, we amended our senior credit facility to allow for additional senior term notes in the amount of $160.0 million. The funds borrowed from the additional senior term notes were primarily used to fund the acquisition of Healthy Pet on June 1, 2007. The terms, including the interest rate, of these additional senior term notes are the same as the senior term notes existing prior to the amendment. Principal payments on the additional senior term notes are due quarterly in the amount of $400,000 and a final payment in the amount of $153.6 million is due on May 16, 2011. In connection with this amendment, we incurred debt-issue costs in the amount of $897,000.

During the nine months ended September 30, 2007, we entered into the following interest rate swap agreements to mitigate our exposure to the risk of interest rates increasing:

Fixed interest rate	4.95%	5.34%
Notional amount (in millions)	$75.0	$100.0
Effective date	4/30/2007	6/11/2007
Expiration date	4/30/2009	12/31/2009
Counterparties	Wells Fargo	Goldman Sachs
Qualifies for hedge accounting	Yes	Yes

Table of Contents

VCA Antech, Inc. and Subsidiaries

Notes To Condensed, Consolidated Financial Statements (Continued)

5. Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquired entity over the net of the fair value of identifiable assets acquired and liabilities assumed. The following table presents the changes in the carrying amount of our goodwill for the nine months ended September 30, 2007 (in thousands):

	Laboratory	Animal Hospital	Medical Technology	Total
Balance as of December 31, 2006	$ 95,310	$ 511,278	$ 19,160	$ 625,748
Goodwill acquired	21	224,348		224,369
Goodwill related to partnership interests		753		753
Other (1)		(2,928)		(2,928)
Balance as of September 30, 2007	$ 95,331	$ 733,451	$ 19,160	$ 847,942

(1) Comprised of purchase price adjustments and the contribution of assets in return for a minority interest in a partially-owned subsidiary.

In addition to goodwill, we have amortizable intangible assets at September 30, 2007 and December 31, 2006 as follows (in thousands):

	As of September 30, 2007			As of December 31, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Covenants not-to-compete	$ 14,110	$ (6,890)	$ 7,220	$ 12,687	$ (6,169)	$ 6,518
Non-contractual customer relationships	10,459	(2,204)	8,255	9,869	(1,553)	8,316
Technology	1,270	(758)	512	1,270	(568)	702
Trademarks	582	(170)	412	569	(127)	442
Contracts	380	(285)	95	397	(231)	166
Client lists	136	(44)	92	506	(357)	149
Total	$ 26,937	$ (10,351)	$ 16,586	$ 25,298	$ (9,005)	$ 16,293

The following table summarizes our aggregate amortization expense related to other intangible assets (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006

Aggregate amortization expense	$ 967	$ 933	$ 2,997	$ 2,661

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes To Condensed, Consolidated Financial Statements (Continued)

5. Goodwill and Other Intangible Assets, continued

The estimated amortization expense related to intangible assets for each of the five succeeding years and thereafter as of September 30, 2007 is as follows (in thousands):

Remainder of 2007	$ 997
2008	3,556
2009	2,512
2010	1,739
2011	1,250
Thereafter	6,532
Total	$ 16,586

6. Share-Based Compensation

Stock Option Activity

A summary of our stock option activity for the nine months ended September 30, 2007 is as follows (in thousands, except weighted-average exercise price and weighted-average remaining contractual term):

	Stock Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2006	5,290	$ 15.72	5.0	$ 87,136
Granted				
Exercised	(650)	10.26		
Forfeited/Canceled	(83)	20.59		
Outstanding at September 30, 2007	4,557	$ 16.41	4.3	$ 115,472
Exercisable at September 30, 2007	4,030	$ 16.32	4.4	$ 102,487
Expected to vest at September 30, 2007	510	$ 17.10	3.5	$ 12,580

The following table summarizes information about the options outstanding at September 30, 2007 (in thousands, except per share amounts and the weighted-average remaining contractual life):

	Options Outstanding			Options Exercisable	
Exercise Price	Number Outstanding	Weighted-Avg. Remaining Contractual Life	Weighted-Avg. Exercise Price	Number Exercisable	Weighted-Avg. Exercise Price

$0.50	149	3.0	$ 0.50	149	$ 0.50
$6.26 - $7.97	1,114	5.2	$ 7.01	1,114	$ 7.01
$15.33 - $30.70	3,294	4.0	$ 20.30	2,767	$ 20.92
	4,557			4,030	

8

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes To Condensed, Consolidated Financial Statements (Continued)

6. Share-Based Compensation, continued

At September 30, 2007, there was $1.8 million of total unrecognized compensation cost related to our stock options. This cost is expected to be recognized over a weighted-average period of 1.0 years.

Non-vested Stock Activity

During the nine months ended September 30, 2007, we granted 351,432 non-vested shares of common stock with a weighted-average grant date fair value of $32.75 per share. At September 30, 2007, there was $9.1 million of unrecognized compensation cost related to these non-vested shares that will be recognized over a weighted-average period of 3.3 years.

7. Income Taxes

The effective tax rate for the nine months ended September 30, 2007 and 2006 was 40.0% and 34.2%, respectively. The effective tax rate for the nine months ended September 30, 2006 includes a tax benefit in the amount of $6.8 million recognized during the first quarter of 2006 due to the outcome of an income tax audit that resulted in a reduction to our estimated tax liabilities.

8. Comprehensive Income

Comprehensive income consists of net income and other comprehensive loss. The following table provides a summary of comprehensive income (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income	$ 32,229	$ 26,977	$ 96,389	$ 86,189
Other comprehensive loss:				
Unrealized loss on hedging instruments, net of tax	(2,171)	(1,262)	(2,359)	(517)
Loss (gain) on hedging instruments reclassified to income, net of tax	65	44	201	(14)
Other comprehensive loss	(2,106)	(1,218)	(2,158)	(531)
Total comprehensive income	$ 30,123	$ 25,759	$ 94,231	$ 85,658

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes To Condensed, Consolidated Financial Statements (Continued)

9. Calculation of Earnings per Share

Basic earnings per share is calculated by dividing net income by the weighted-average number of shares outstanding during each period. Diluted earnings per share is calculated by dividing net income by the weighted-average number of common shares outstanding after giving effect to all dilutive potential common shares outstanding during each period. Basic and diluted earnings per share were calculated as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income	$ 32,229	$ 26,977	$ 96,389	$ 86,189
Weighted-average common shares outstanding:				
Basic	83,957	83,339	83,769	83,092
Effect of dilutive potential common shares:				
Stock options and non-vested shares	1,795	1,848	1,803	1,772
Diluted	85,752	85,187	85,572	84,864
Basic earnings per share	$ 0.38	$ 0.32	$ 1.15	$ 1.04
Diluted earnings per share	$ 0.38	$ 0.32	$ 1.13	$ 1.02

For the nine months ended September 30, 2007 and the three and nine months ended September 30, 2006, potential common shares of 49,729 and 39,341, respectively, were excluded from the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect. There were no anti-dilutive shares for the three months ended September 30, 2007.

10. Segment Reporting

Our reportable segments are Laboratory, Animal Hospital, and Medical Technology. These segments are strategic business units that have different services, products and/or functions. The segments are managed separately because each is a distinct and different business venture with unique challenges, risks and rewards. Our laboratory segment provides diagnostic laboratory testing services for veterinarians, both associated with our animal hospitals and those independent of us. Our animal hospital segment provides veterinary services for companion animals and sells related retail and pharmaceutical products. Our medical technology segment sells digital radiography and ultrasound imaging equipment, related computer hardware, software and ancillary services to the veterinary market. We also operate a corporate office that provides general and administrative support services for our other segments.

The accounting policies of our segments are the same as those described in the summary of significant accounting policies included in our 2006 Annual Report on Form 10-K. We evaluate the performance of our segments based on gross profit and operating income. For purposes of reviewing the operating performance of our segments, all intercompany sales and purchases are accounted for as if they were transactions with independent third parties at current market prices.

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes To Condensed, Consolidated Financial Statements (Continued)

10. Segment Reporting, continued

Below is a summary of certain financial data for each of our segments (in thousands):

	Laboratory	Animal Hospital	Medical Technology	Corporate	Intercompany Eliminations	Total
Three Months Ended September 30, 2007						
External revenue	$ 66,964	$ 229,409	$ 10,164	$	$	$ 306,537
Intercompany revenue	7,302		927		(8,229)	
Total revenue	74,266	229,409	11,091		(8,229)	306,537
Direct costs	38,628	181,825	7,830		(8,048)	220,235
Gross profit	35,638	47,584	3,261		(181)	86,302
Selling, general and administrative expense	4,859	5,411	2,761	9,264		22,295
Loss on sale of assets	14	312	6	1		333
Operating income (loss)	$ 30,765	$ 41,861	$ 494	$ (9,265)	$ (181)	$ 63,674
Depreciation and amortization	$ 1,742	$ 4,461	$ 409	$ 512	$ (100)	$ 7,024
Capital expenditures	$ 2,084	$ 7,383	$ 142	$ 1,468	$ (280)	$ 10,797
Three Months Ended September 30, 2006						
External revenue	$ 60,261	$ 183,592	$ 7,779	$	$	$ 251,632
Intercompany revenue	5,793		1,177		(6,970)	
Total revenue	66,054	183,592	8,956		(6,970)	251,632
Direct costs	36,041	146,132	5,530		(6,536)	181,167
Gross profit	30,013	37,460	3,426		(434)	70,465
Selling, general and administrative expense	4,350	5,161	2,534	6,901		18,946
Loss (gain) on sale of assets	6	(3)				3
Operating income (loss)	$ 25,657	$ 32,302	$ 892	$ (6,901)	$ (434)	$ 51,516
Depreciation and amortization	$ 1,221	$ 3,577	$ 315	$ 424	$ (41)	$ 5,496
Capital expenditures	$ 2,388	$ 4,747	$ 404	$ 1,354	$ (160)	$ 8,733

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes To Condensed, Consolidated Financial Statements (Continued)

10. Segment Reporting, continued

	Laboratory	Animal Hospital	Medical Technology	Corporate	Intercompany Eliminations	Total
Nine Months Ended September 30, 2007						
External revenue	$ 206,233	$ 635,046	$ 30,708	$	$	$ 871,987
Intercompany revenue	20,840		2,190		(23,030)	
Total revenue	227,073	635,046	32,898		(23,030)	871,987
Direct costs	115,467	505,581	21,541		(22,702)	619,887
Gross profit	111,606	129,465	11,357		(328)	252,100
Selling, general and administrative expense	14,872	16,292	8,389	26,258		65,811
Loss on sale of assets	72	756	46	1		875
Operating income (loss)	$ 96,662	$ 112,417	$ 2,922	$ (26,259)	$ (328)	$ 185,414
Depreciation and amortization	$ 4,688	$ 12,751	$ 1,216	$ 1,390	$ (281)	$ 19,764
Capital expenditures	$ 9,808	$ 23,663	$ 566	$ 4,604	$ (608)	$ 38,033
Nine Months Ended September 30, 2006						
External revenue	$ 177,964	$ 540,117	$ 22,881	$	$	$ 740,962
Intercompany revenue	17,100		2,467		(19,567)	
Total revenue	195,064	540,117	25,348		(19,567)	740,962
Direct costs	103,977	430,409	16,276		(18,648)	532,014
Gross profit	91,087	109,708	9,072		(919)	208,948
Selling, general and administrative expense	12,793	15,107	7,734	21,681		57,315
Loss (gain) on sale of assets	14	(214)				(200)
Operating income (loss)	$ 78,280	$ 94,815	$ 1,338	$ (21,681)	$ (919)	$ 151,833
Depreciation and amortization	$ 3,373	$ 10,674	$ 1,089	$ 1,320	$ (109)	$ 16,347
Capital expenditures	$ 5,352	$ 16,124	$ 489	$ 2,294	$ (459)	$ 23,800

At September 30, 2007

Total assets	$ 178,942	$ 933,828	$ 50,069	$ 117,801	$ (7,495)	$ 1,273,145
At December 31, 2006						
Total assets	$ 167,363	$ 671,975	$ 53,161	$ 85,533	$ (6,075)	$ 971,957

11. Commitments and Contingencies

We have certain commitments, including operating leases and supply purchase agreements. These items are discussed in detail in our consolidated financial statements and notes thereto included in our 2006 Annual Report on Form 10-K. We also have contingencies as follows:

a. Earn-out Payments

We have contractual arrangements in connection with certain acquisitions, whereby additional cash may be paid to former owners of acquired companies upon attainment of specified financial criteria as set forth in the respective agreements. The amount to be paid cannot be determined until the earn-out periods expire and the attainment of

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes To Condensed, Consolidated Financial Statements (Continued)

11. Commitments and Contingencies, continued

criteria is established. If the specified financial criteria are attained, we will be obligated to pay an additional $938,000.

b. Officers Compensation

Our Chief Executive Officer (CEO), Chief Operating Officer (COO) and Chief Financial Officer (CFO) have entered into employment agreements with our company that provide for base salaries and annual bonuses set by our Compensation Committee of the Board of Directors.

As of any given date, under their contracts, each officer has the remaining term: five years for the CEO, three years for the COO and two years for the CFO. The contracts have the following additional provisions:

In the event any of these officers employment is terminated due to death or disability, each officer, or their estate, is entitled to receive the remaining base salary during the remaining scheduled term of his employment agreement, the acceleration of the vesting of his options, which options shall remain exercisable for the full term, and the right to continue receiving specified benefits and perquisites.

In the event any of these officers terminate their employment agreements for cause, we terminate any of their employment agreements without cause or a change of control occurs (in which case such employment agreements terminate automatically), each officer is entitled to receive the remaining base salary during the remaining scheduled term of his employment agreement, a bonus based on past bonuses, the acceleration of the vesting of his options, which options shall remain exercisable for the full term, and the right to continue receiving specified benefits and perquisites.

In the event of a change of control, the cash value of all benefits due under their employment contracts as a result of the termination would be immediately payable to the officers. In addition, if any of the amounts payable to these officers under these provisions constitute excess parachute payments under the Internal Revenue Code, each officer is entitled to an additional payment to cover the tax consequences associated with the excess parachute payment.

In addition to the agreements described above, we entered into an agreement with one of our Senior Vice Presidents whereby in the event his employment is terminated for any reason other than cause, he is entitled to receive an amount equal to one year s base salary in effect at the date of termination and the right to continue receiving specified benefits and perquisites for a period of one year. Our Senior Vice President s base salary and annual bonus are set by our Compensation Committee of the Board of Directors.

c. Other Contingencies

We have certain contingent liabilities resulting from litigation and claims incidental to the ordinary course of our business that we believe will not have a material adverse effect on our future consolidated financial position, results of operations or cash flows.

12. Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes recognition thresholds and measurement attributes for the financial statement recognition of uncertain income tax positions. In the first quarter of 2007, we adopted FIN 48. We did not have any unrecognized tax benefits at September 30, 2007, and the adoption of FIN 48 did not have a material effect on our condensed, consolidated financial statements.

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes To Condensed, Consolidated Financial Statements (Continued)

12. Recent Accounting Pronouncements, continued

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS No. 157), which establishes a framework for using and disclosing estimates in accounting for certain assets, liabilities and transactions at fair value. The provisions of SFAS No. 157 will be effective for our company on January 1, 2008. We are currently evaluating the impact of adopting SFAS No. 157 on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB No.115* (SFAS No. 159), which permits entities to choose to measure certain financial instruments and other items at fair value. The provisions of SFAS No. 159 will be effective for our company on January 1, 2008. We are currently evaluating the impact of adopting SFAS No. 159 on our consolidated financial statements.

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

	Page Number
Introduction	16
Executive Overview	16
Consolidated Results of Operations	18
Segment Results	20
Liquidity and Capital Resources	23
Critical Accounting Policies	25
Recent Accounting Pronouncements	26
Forward-Looking Statements	26

Table of Contents

Introduction

The following discussion should be read in conjunction with our condensed, consolidated financial statements provided under Part I, Item I of this Quarterly Report on Form 10-Q. We have included herein statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We generally identify forward-looking statements in this report using words like believe, intend, expect, estimate, ma plan, should plan, project, contemplate, anticipate, predict, potential, continue, or similar expressions. some of these statements below and elsewhere in this report. These forward-looking statements are not historical facts and are inherently uncertain and outside of our control. Any or all of our forward-looking statements in this report may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this report will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially. Factors that may cause our plans, expectations, future financial condition and results to change are described throughout this report and in our Annual Report on Form 10-K, particularly in Risk Factors, Part I, Item 1A of that report.

The forward-looking information set forth in this Quarterly Report on Form 10-Q is as of November 6, 2007, and we undertake no duty to update this information. Shareholders and prospective investors can find information filed with the SEC after November 6, 2007 at our website at www.investor.vcaantech.com or at the SEC s website at www.sec.gov.

We are a leading national animal healthcare company that provides veterinary services and diagnostic testing to support veterinary care and we sell diagnostic imaging equipment, other medical technology products and related services to veterinarians. Our reportable segments are as follows:

Our laboratory segment operates the largest network of veterinary diagnostic laboratories in the nation. Our laboratories provide sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. At September 30, 2007, our laboratory network consisted of 35 laboratories serving all 50 states.

Our animal hospital segment operates the largest network of freestanding, full-service animal hospitals in the nation. Our animal hospitals offer a full range of general medical and surgical services for companion animals. We treat diseases and injuries, offer pharmaceutical and retail products and perform a variety of pet wellness programs, including health examinations, diagnostic testing, routine vaccinations, spaying, neutering and dental care. At September 30, 2007, our animal hospital network consisted of 441 animal hospitals in 38 states.

Our medical technology segment sells digital radiography and ultrasound imaging equipment, related computer hardware, software and ancillary services.

The practice of veterinary medicine is subject to seasonal fluctuation. In particular, demand for veterinary services is significantly higher during the warmer months because pets spend a greater amount of time outdoors where they are more likely to be injured and are more susceptible to disease and parasites. In addition, use of veterinary services may be affected by levels of flea infestation, heartworm and ticks, and the number of daylight hours.

Executive Overview

The three and nine months ended September 30, 2007 was marked by continued growth in our laboratory and animal hospital operating segments achieved through a combination of internal growth and acquisitions, including the acquisition of Healthy Pet Corp. (Healthy Pet) on June 1, 2007. For the three and nine months ended September 30, 2007, our laboratory internal revenue growth was 11.6% and 14.9%, respectively, and our animal hospital same-store revenue growth, adjusted for one less business day in the current periods, was 5.7% and 6.0%, respectively.

Table of Contents

Acquisitions and Facilities

Our growth strategy includes the acquisition of independent animal hospitals. We currently anticipate that animal hospital acquired revenue for 2007 (exclusive of our acquisition of Healthy Pet discussed below) will range from $60.0 million to $65.0 million. In addition, we also evaluate the acquisition of animal hospital chains, laboratories or related businesses if favorable opportunities are presented. In accordance with that strategy, on June 1, 2007, we acquired Healthy Pet, which operated at the time of its acquisition, 44 animal hospitals and a small laboratory, which primarily serviced its own animal hospitals. The acquisition of Healthy Pet allowed us to expand our animal hospital operations, particularly in Massachusetts, Connecticut, Virginia and Georgia. The following table summarizes the changes in the number of facilities operated by our laboratory and animal hospital segments during the nine months ended September 30, 2007:

Laboratories:	
Beginning of period	33
Acquisitions	2
Acquisitions relocated into our exising laboratories	(1)
New facilities	1
End of period	35
Animal hospitals:	
Beginning of period	379
Acquisitions, excluding Healthy Pet	29
Healthy Pet	44
Acquisitions relocated into our existing animal hospitals	(7)
Closed	(4)
End of period	441

Financing Transaction

On June 1, 2007, we amended our senior credit facility to allow for additional senior term notes in the amount of $160.0 million. We used the funds borrowed from the additional senior term notes to fund the acquisition of Healthy Pet on June 1, 2007. The terms, including the interest rate, of these additional senior term notes are the same as the senior term notes existing prior to the amendment. Principal payments on the additional senior term notes are due quarterly in the amount of $400,000 and a final payment in the amount of $153.6 million is due on May 16, 2011.

Consolidated Results of Operations

The following table sets forth components of our condensed, consolidated income statements expressed as a percentage of revenue:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Revenue:				
Laboratory	24.2%	26.3%	26.0%	26.3%
Animal hospital	74.8	73.0	72.8	72.9
Medical technology	3.6	3.6	3.8	3.4
Intercompany	(2.6)	(2.9)	(2.6)	(2.6)
Total revenue	100.0	100.0	100.0	100.0
Direct costs	71.8	72.0	71.1	71.8
Gross profit	28.2	28.0	28.9	28.2
Selling, general and administrative expense	7.3	7.5	7.5	7.7
Loss on sale of assets	0.1		0.1	
Operating income	20.8	20.5	21.3	20.5
Interest expense, net	2.9	2.4	2.5	2.5
Other expense		0.1		
Minority interest in income of subsidiairies	0.4	0.3	0.4	0.3
Income before provision for income taxes	17.5	17.7	18.4	17.7
Provision for income taxes	7.0	7.0	7.3	6.1
Net income	10.5%	10.7%	11.1%	11.6%

Revenue

The following table summarizes our revenue (in thousands, except percentages):

	Three Months Ended September 30,					Nine Months Ended September 30,				
	2007		2006			2007		2006		
	$	% of Total	$	% of Total	% Change	$	% of Total	$	% of Total	% Change
Laboratory	$ 74,266	24.2%	$ 66,054	26.3%	12.4%	$ 227,073	26.0%	$ 195,064	26.3%	16.4%
Animal hospital	229,409	74.8%	183,592	73.0%	25.0%	635,046	72.8%	540,117	72.9%	17.6%
Medical technology	11,091	3.6%	8,956	3.6%	23.8%	32,898	3.8%	25,348	3.4%	29.8%
Intercompany	(8,229)	(2.6)%	(6,970)	(2.9)%	18.1%	(23,030)	(2.6)%	(19,567)	(2.6)%	17.7%
Total revenue	$ 306,537	100.0%	$ 251,632	100.0%	21.8%	$ 871,987	100.0%	$ 740,962	100.0%	17.7%

Consolidated revenue increased $54.9 million for the three months ended September 30, 2007, and $131.0 million for the nine months ended September 30, 2007. The increases in revenue were attributable to revenue from acquired animal hospitals, including Healthy Pet, and organic growth. Our laboratory internal revenue growth was 11.6% and 14.9% for the three and nine months ended September 30, 2007, respectively. Our animal hospital same-store revenue growth, adjusted for one less business day in the current periods, was 5.7% and 6.0% for the three and nine months ended September 30, 2007.

Gross Profit

The following table summarizes our gross profit and our gross profit as a percentage of applicable revenue, or gross margin (in thousands, except percentages):

	Three Months Ended September 30,					Nine Months Ended September 30,				
	2007		2006			2007		2006		
	$	Gross Margin	$	Gross Margin	% Change	$	Gross Margin	$	Gross Margin	% Change
Laboratory	$ 35,638	48.0%	$ 30,013	45.4%	18.7%	$ 111,606	49.1%	$ 91,087	46.7%	22.5%
Animal hospital	47,584	20.7%	37,460	20.4%	27.0%	129,465	20.4%	109,708	20.3%	18.0%
Medical technology	3,261	29.4%	3,426	38.3%	(4.8)%	11,357	34.5%	9,072	35.8%	25.2%
Intercompany	(181)		(434)			(328)		(919)		
Total gross profit	$ 86,302	28.2%	$ 70,465	28.0%	22.5%	$ 252,100	28.9%	$ 208,948	28.2%	20.7%

Consolidated gross profit increased $15.8 million for the three months ended September 30, 2007, and $43.2 million for the nine months ended September 30, 2007. The increases were primarily due to the increase in consolidated revenue discussed above and an increase in consolidated gross margins in comparison to the previous year. The improvement in our consolidated gross margins were primarily attributable to the operating leverage realized by our laboratory segment due to the fixed cost nature of its business.

Selling, General and Administrative Expense

The following table summarizes our selling, general and administrative expense (SG&A), and our expense as a percentage of applicable revenue (in thousands, except percentages):

	Three Months Ended September 30,					Nine Months Ended September 30,				
	2007		2006			2007		2006		
	$	% of Revenue	$	% of Revenue	% Change	$	% of Revenue	$	% of Revenue	% Change
Laboratory	$ 4,859	6.5%	$ 4,350	6.6%	11.7%	$ 14,872	6.5%	$ 12,793	6.6%	16.3%
Animal hospital	5,411	2.4%	5,161	2.8%	4.8%	16,292	2.6%	15,107	2.8%	7.8%
Medical technology	2,761	24.9%	2,534	28.3%	9.0%	8,389	25.5%	7,734	30.5%	8.5%
Corporate	9,264	3.0%	6,901	2.7%	34.2%	26,258	3.0%	21,681	2.9%	21.1%
Total SG&A	$ 22,295	7.3%	$ 18,946	7.5%	17.7%	$ 65,811	7.5%	$ 57,315	7.7%	14.8%

Consolidated selling, general and administrative expense increased $3.3 million for the three months ended September 30, 2007, and $8.5 million for the nine months ended September 30, 2007. The increases were primarily attributable to expanding our administrative operations in order to manage our recent acquisitions, an increase in share-based compensation expense due to non-vested shares granted in 2007, and an increase in commissions as a result of our laboratory s strong operating performance. In addition, we incurred integration costs in connection with the acquisition of Healthy Pet. These integration costs consisted primarily of salaries and occupancy costs for operating Healthy Pet s corporate office subsequent to the acquisition date and totaled $700,000 and $1.4 million for the three and nine months ended September 30, 2007, respectively.

Loss (Gain) on Sale of Assets

During the nine months ended September 30, 2007 and 2006, we sold certain assets, including real estate, for a net loss of $875,000 and a gain of $200,000, respectively.

Table of Contents

Interest Expense, Net

The following table summarizes our interest expense, net of interest income (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Interest expense:				
Senior term notes	$ 9,432	$ 6,597	$ 23,205	$ 19,515
Interest rate swap agreements	(433)	(484)	(1,450)	(1,054)
Capital leases and other	811	432	1,510	1,041
Amortization of debt costs	116	73	253	299
	9,926	6,618	23,518	19,801
Interest income	996	534	2,144	1,478
Interest expense, net	$ 8,930	$ 6,084	$ 21,374	$ 18,323

The increase in interest expense was primarily attributable to additional senior term notes in the amount of $160.0 million borrowed under our senior credit facility on June 1, 2007 and increases in LIBOR. These factors were partially offset by principal repayments, including $60.0 million of voluntary debt repayments throughout 2006.

Provision for Income Taxes

Our effective tax rates for the three months ended September 30, 2007 and 2006 were 39.8% and 39.4%, respectively, and our effective tax rates for the nine months ended September 30, 2007 and 2006 were 40.0% and 34.2%, respectively. The effective tax rate for the nine months ended September 30, 2006 included a tax benefit in the amount of $6.8 million recognized during the first quarter of 2006 due to the outcome of an income tax audit that resulted in a reduction to our estimated tax liabilities.

Segment Results

Laboratory Segment

Laboratory revenue increased $8.2 million for the three months ended September 30, 2007, and $32.0 million for the nine months ended September 30, 2007. The components of the increases in laboratory revenue are detailed below (in thousands, except percentages and average price per requisition):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2007	2006	% Change	2007	2006	% Change
Internal growth:						
Number of requisitions (1)	3,104	2,822	10.0%	9,615	8,446	13.8%
Average revenue per requisition (2)	$ 23.74	$ 23.41	1.4%	$ 23.31	$ 23.10	0.9%
Total internal revenue (1)	$ 73,686	$ 66,054	11.6%	$ 224,089	$ 195,064	14.9%
Acquired revenue (3)	580			2,984		
Total	$ 74,266	$ 66,054	12.4%	$ 227,073	$ 195,064	16.4%

(1) Internal revenue and requisitions

were calculated using laboratory operating results, adjusted to exclude the operating results of acquired laboratories for the comparable periods that we did not own those laboratories in the prior year, and adjusted for the impact resulting from any differences in the number of billing days in the comparable periods.

(2) Computed by dividing internal revenue by the number of requisitions.

(3) Acquired revenue represents revenue recognized from our acquired laboratories for the comparable current year period that we did not own them in the prior year.

Table of Contents

The increase in requisitions from internal growth is the result of a continued trend in veterinary medicine to focus on the importance of laboratory diagnostic testing in the diagnosis, early detection and treatment of diseases, and the migration of certain tests to outside laboratories that have historically been performed in veterinary hospitals. This trend is driven by an increase in the number of specialists in the veterinary industry relying on diagnostic testing, the increased focus on diagnostic testing in veterinary schools and general increased awareness through ongoing marketing and continuing education programs provided by us, pharmaceutical companies and other service providers in the industry. Also contributing to the year-to-date increase in the number of requisitions was testing related to the pet food recall that occurred in March 2007.

No single customer represented more than 10% of our laboratory revenues during the periods presented. We derive our laboratory revenue from services provided to over 15,000 independently owned animal hospitals and shifts in the purchasing habits of any individual animal hospital or small group of animal hospitals is not material to our laboratory revenues. Other companies are developing networks of animal hospitals, however, and shifts in the purchasing habits of these networks have the potential of a greater impact on our laboratory revenues.

The change in the average revenue per requisition is attributable to changes in the mix, including performing lower-priced tests historically performed at veterinary hospitals, type and number of tests performed per requisition and price increases. The price increases for most tests ranged from 3% to 5% in February 2007 and February 2006.

Laboratory gross profit is calculated as laboratory revenue less laboratory direct costs. Laboratory direct costs are comprised of all costs of laboratory services, including but not limited to, salaries of veterinarians, specialists, technicians and other laboratory-based personnel, transportation and delivery costs, supply costs, facilities rent, occupancy costs, depreciation and amortization.

The increase in laboratory gross margin was primarily attributable to increases in laboratory revenue combined with operating leverage associated with our laboratory business. Our operating leverage comes from the incremental margins we realize on additional tests ordered by the same client, as well as when more comprehensive tests are ordered. We are able to benefit from these incremental margins due to the relative fixed cost nature of our laboratory business.

Animal Hospital Segment

Animal hospital revenue increased $45.8 million for the three months ended September 30, 2007, and $94.9 million for the nine months ended September 30, 2007. The components of the increases are summarized in the following table (in thousands, except percentages and average price per order):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2007	**2006**	**% Change**	**2007**	**2006**	**% Change**
Same-store facilities:						
Orders (1)(2)	1,380	1,385	(0.3)%	3,919	3,911	0.2%
Average revenue per order (3)	$ 138.48	$ 130.59	6.0%	$ 140.80	$ 133.12	5.8%
Same-store revenue (1)	$ 191,135	$ 180,842	5.7%	$ 551,853	$ 520,689	6.0%
Business day adjustment (4)		1,619			1,550	
Net acquired revenue (5)	38,274	1,131		83,193	17,878	
Total	$ 229,409	$ 183,592	25.0%	$ 635,046	$ 540,117	17.6%

(1) Same-store revenue and orders were

calculated using animal hospital operating results, adjusted to exclude the operating results for newly acquired animal hospitals that we did not own as of the beginning of the comparable period in the prior year and adjusted for the impact resulting from any differences in the number of business days in the comparable periods. Same-store revenue also includes revenue generated by customers referred from our relocated or combined animal hospitals, including those merged upon acquisition.

(2) The change in orders may not calculate exactly due to rounding.

(3) Computed by dividing same-store revenue by same-store orders. The average revenue per order may

not calculate
exactly due to
rounding.

Table of Contents

(4) The 2006 business day adjustment reflects the impact of one additional business day in 2006 as compared to 2007 for both 2007 periods presented.

(5) Net acquired revenue represents the revenue from those animal hospitals acquired, net of revenue from those animal hospitals sold or closed, on or after the beginning of the comparable period, which was July 1, 2006 for the three-month analysis, and January 1, 2006 for the nine-month analysis. Fluctuations in net acquired revenue occur due to the volume, size and timing of acquisitions and dispositions during the periods from this date through the end

of the applicable
period.

Our business strategy is to place a greater emphasis on comprehensive wellness visits and advanced medical procedures, which typically generate higher-priced orders. Over the last few years, some pet-related products traditionally sold in our animal hospitals are now widely available in retail stores and other distribution channels. In addition, there has been a decline in the number of vaccinations as some recent professional literature and research has suggested that vaccinations can be given to pets less frequently. These trends have resulted in a decrease in lower-priced orders and an increase in higher-priced orders. Although we experienced an increase in the number of orders for the nine months ended September 30, 2007, we may continue to experience a decrease in the number of orders in future periods for the reasons discussed above.

Price increases, which approximated 5% to 6% on most services at most of our hospitals in February 2007 and February 2006, also contributed to the increase in the average revenue per order. Prices are reviewed on an annual basis for each hospital and adjustments are made based on market considerations, demographics and our costs.

Animal hospital gross profit is calculated as animal hospital revenue less animal hospital direct costs. Animal hospital direct costs are comprised of all costs of services and products at the animal hospitals, including, but not limited to, salaries of veterinarians, technicians and all other animal hospital-based personnel, facilities rent, occupancy costs, supply costs, depreciation and amortization, certain marketing and promotional expense and costs of goods sold associated with the retail sales of pet food and pet supplies.

During the three and nine months ended September 30, 2007, our animal hospital gross margin increased primarily as a result of improvements in our same-store animal hospital revenue and operating leverage. Our animal hospital same-store gross margins were 21.0% and 20.5% for the three months ended September 30, 2007 and 2006, respectively, and 20.8% and 20.5% for the nine months ended September 30, 2007 and 2006, respectively.

Medical Technology Segment

Medical technology revenue increased $2.1 million and $7.6 million for the three and nine months ended September 30, 2007 as compared to the prior year. The increase was primarily due to a rise in the amount of revenue recognized on sales of our digital radiography and ultrasound imaging equipment. The increase due to sales of digital radiography imaging equipment was primarily due to the structure of digital radiography sale agreements in the prior year that resulted in more revenue being deferred as compared to the current period. We recognize revenue on deferred sales ratably over a period ranging from one to five years. These deferred transactions are discussed in greater detail in the *Critical Accounting Policies* section of our 2006 Annual Report on Form 10-K. Although we recognized an increase in ultrasound revenue, we believe the business life cycle for ultrasound imaging equipment is maturing and accordingly, the demand for these types of products and related services may decline in the near term.

Medical technology gross profit is calculated as medical technology revenue less medical technology direct costs. Medical technology direct costs are comprised of all product and service costs, including, but not limited to, all costs of equipment, related products and services, salaries of technicians, support personnel, trainers, consultants and other non-administrative personnel depreciation and amortization and supply costs.

The changes in medical technology gross profit and gross margin are the result of changes in the mix of products and services sold and an increase in material cost as a percentage of revenue related to the sale of our digital radiography and ultrasound imaging equipment.

Intercompany Revenue

Laboratory revenue for the three and nine months ended September 30, 2007 included intercompany revenue of $7.3 million and $20.8 million, respectively, that was generated by providing laboratory services to our animal hospitals. Medical technology revenue for the three and nine months ended September 30, 2007 included intercompany revenue of $927,000 and $2.2 million, respectively, that was generated by providing products and

Table of Contents

services to our animal hospitals and laboratories. For purposes of reviewing the operating performance of our business segments, all intercompany transactions are accounted for as if the transaction was with an independent third party at current market prices. For financial reporting purposes, intercompany transactions are eliminated as part of our consolidation.

Liquidity and Capital Resources

The following table summarizes our cash flows (in thousands):

	Nine Months Ended September 30,	
	2007	**2006**
Cash provided by (used in):		
Operating activities	$ 135,153	$ 90,738
Investing activities	(259,167)	(63,483)
Financing activities	166,065	(52,922)
Increase (decrease) in cash and cash equivalents	42,051	(25,667)
Cash and cash equivalents at beginning of year	45,104	58,488
Cash and cash equivalents at end of period	$ 87,155	$ 32,821

Cash Flows from Operating Activities

Net cash provided by operating activities increased $44.4 million in the nine months ended September 30, 2007, in comparison to the prior year. The increase was primarily due to acquisitions and improved operating performance, a decline in taxes paid of $5.1 million, changes in working capital, partially offset by an increase in interest paid of $3.6 million.

Cash Flows from Investing Activities

Our growth strategy includes the acquisition of independent animal hospitals. We currently anticipate that we will spend $60.0 million to $65.0 million in 2007 on the acquisition of animal hospitals (exclusive of our acquisition of Healthy Pet discussed below). For the nine months ended September 30, 2007, we spent $59.2 million primarily related to the acquisition of independent animal hospitals, excluding Healthy Pet. In addition, we also evaluate the acquisition of animal hospital chains, laboratories or related businesses if favorable opportunities are presented. In accordance with that strategy, we spent $154.8 million for the acquisition of Healthy Pet. We intend to primarily use cash in our acquisitions but, depending on the timing and amount of our acquisitions, we may use stock or debt.

Our investing activities include expenditures for property and equipment additions and we expect to spend approximately $45.0 million in 2007 for such expenditures (exclusive of real estate acquired in connection with business acquisitions). For the nine months ended September 30, 2007, we spent $38.0 million on property and equipment additions. In addition, due to favorable opportunities presented, we also purchased real estate in connection with certain animal hospital acquisitions in the amount of $8.0 million during the nine months ended September 30, 2007.

Cash Flows from Financing Activities

Net cash provided by our financing activities for the nine months ended September 30, 2007 included $160.0 million of borrowings under our senior credit facility in the form of additional senior term notes. We used these borrowings to fund the acquisition of Healthy Pet on June 1, 2007. We used net cash in our financing activities for the nine months ended September 30, 2006 primarily to prepay a portion of our senior term notes in the amount of $60.0 million.

Table of Contents

Future Cash Requirements

The following table sets forth our scheduled principal, interest and other contractual cash obligations for each of the years indicated (in thousands):

	Total	2007 (1)	2008	2009	2010	2011	Thereafter
Long-term debt	$ 531,485	$ 1,755	$ 6,106	$ 5,828	$ 5,855	$ 511,941	$
Capital lease obligations	30,717	465	1,837	1,909	2,073	2,181	22,252
Operating leases	564,508	8,396	37,348	37,013	35,067	34,822	411,862
Fixed cash interest expense	14,874	600	2,469	2,131	1,750	1,434	6,490
Variable cash interest expense (2)	113,837	8,427	30,882	30,306	31,815	12,407	
Swap agreements (2)	3,284		1,816	1,468			
Purchase obligations	44,442	11,663	8,134	8,899	9,744	6,002	
Other long-term liabilities (3)	53,264	531	1,003	934	826	665	49,305
Earn-out payments (4)	938	213	375	350			
	$ 1,357,349	$ 32,050	$ 89,970	$ 88,838	$ 87,130	$ 569,452	$ 489,909

(1) Consists of the period from October 1, 2007 through December 31, 2007.

(2) We have variable-rate debt. The interest payments on our variable-rate debt are based on a variable-rate component plus a margin of 1.50%. For purposes of this computation, we have assumed that the interest rate on our variable-rate debt (including the margin of 1.50%) will be 6.37%, 5.88%, 5.83%, 6.18% and 6.43% for

years 2007 through 2011, respectively. These estimates are based on interest rate projections used to price our interest rate swap agreements. Our consolidated financial statements included in our 2006 Annual Report on Form 10-K discuss these variable-rate notes in more detail.

(3) Includes deferred income taxes of $45.6 million.

(4) Represents contractual arrangements whereby additional cash may be paid to former owners of acquired businesses upon attainment of specified performance targets.

We anticipate that our cash on-hand, net cash provided by operations and, if needed, our revolving credit facility, will provide sufficient cash resources to fund our operations for more than the next 12 months. If we consummate one or more significant acquisitions during this period we may need to seek additional debt or equity financing.

Debt Related Covenants

Our senior credit facility contains certain financial covenants pertaining to fixed charge coverage and leverage ratios. In addition, our senior credit facility has restrictions pertaining to capital expenditures, acquisitions and the payment of cash dividends. As of September 30, 2007, we were in compliance with these covenants, including the two covenant ratios, the fixed charge coverage ratio and the leverage ratio.

At September 30, 2007, we had a fixed charge coverage ratio of 1.52 to 1.00, which was in compliance with the required ratio of no less than 1.20 to 1.00. The senior credit facility defines the fixed charge coverage ratio as that ratio

that is calculated on a last 12-month basis by dividing pro forma earnings before interest, taxes, depreciation and amortization, as defined by the senior credit facility (pro forma earnings), by fixed charges. Fixed charges are defined as cash interest expense, scheduled principal payments on debt obligations, capital expenditures, and provision for income taxes. Pro forma earnings include 12 months of operating results for businesses acquired during the period.

At September 30, 2007, we had a leverage ratio of 2.12 to 1.00, which was in compliance with the required ratio of no more than 3.25 to 1.00. The senior credit facility defines the leverage ratio as that ratio which is calculated as total debt divided by pro forma earnings.

Table of Contents

Interest Rate Swap Agreements

We have interest rate swap agreements whereby we pay counterparties amounts based on fixed interest rates and set notional principal amounts in exchange for the receipt of payments from the counterparties based on London Interbank Offer Rates (LIBOR) and the same set notional principal amounts. We entered into these interest rate swap agreements to hedge against the risk of increasing interest rates. The contracts effectively convert a certain amount of our variable-rate debt under our senior credit facility to fixed-rate debt for purposes of controlling cash paid for interest. That amount is equal to the notional principal amount of the interest rate swap agreements, and the fixed-rate conversion period is equal to the terms of the contract. The impact of these interest rate swap agreements has been factored into our future contractual cash requirements table above. All of our interest rate swap agreements at September 30, 2007 qualify for hedge accounting and are summarized as follows:

Fixed interest rate	4.07%	3.98%	5.51%	4.95%	5.34%
Notional amount (in millions)	$50.0	$50.0	$50.0	$75.0	$100.0
Effective date	5/26/2005	6/2/2005	6/20/2006	4/30/2007	6/11/2007
Expiration date	5/26/2008	5/31/2008	6/30/2009	4/30/2009	12/31/2009
Counterparties	Goldman Sachs	Wells Fargo	Goldman Sachs	Wells Fargo	Goldman Sachs

In the future, we may enter into additional interest rate strategies. However, we have not yet determined what those strategies will be or their possible impact.

Description of Indebtedness

Senior Credit Facility

At September 30, 2007, we had $529.0 million principal amount outstanding under our senior term notes and no borrowings outstanding under our revolving credit facility.

We pay interest on our senior term notes and our revolving credit facility based on the interest rate offered to our administrative agent on LIBOR plus a margin of 1.50% per annum.

The senior term notes mature in May 2011 and the revolving credit facility matures in May 2010.

Other Debt

At September 30, 2007, we had seller notes secured by assets of certain animal hospitals, unsecured debt and capital leases that totaled $33.2 million.

Critical Accounting Policies

Our consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States, which require management to make estimates and assumptions that affect reported amounts. The estimates and assumptions are based on historical experience and on other factors that management believes to be reasonable. Actual results may differ from those estimates. Critical accounting policies represent the areas where more significant judgments and estimates are used in the preparation of our consolidated financial statements. A discussion of such critical accounting policies, which include goodwill, revenue recognition, and income taxes can be found in our Annual Report on Form 10-K for the year ended December 31, 2006. Except for income taxes, there have been no material changes to those policies as of this Quarterly Report on Form 10-Q for the period ended September 30, 2007. The methodology applied to management s estimate for income taxes has changed due to the implementation of a new accounting pronouncement as described below.

Effective January 1, 2007, we adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We did not have any unrecognized tax benefits at January 1, 2007, and accordingly, the adoption of FIN 48 did not have a material effect on our condensed, consolidated financial statements.

Table of Contents

Recent Accounting Pronouncements

As mentioned above, in the first quarter of 2007, we adopted FIN 48.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), which establishes a framework for using and disclosing estimates in accounting for certain assets, liabilities and transactions at fair value. The provisions of SFAS No. 157 will be effective for our company on January 1, 2008. We are currently evaluating the impact of adopting SFAS No. 157 on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB No.115* (SFAS No. 159), which permits entities to choose to measure many financial instruments and certain other items at fair value. The provisions of SFAS No. 159 will be effective for our company on January 1, 2008. We are currently evaluating the impact of adopting SFAS No. 159 on our consolidated financial statements.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties, as well as assumptions that, if they materialize or prove incorrect, could cause our results and the results of our consolidated subsidiaries to differ materially from those expressed or implied by these forward-looking statements. We generally identify forward-looking statements in this report using words like believe, intend, expect, estimate, may, plan, shou project, contemplate, anticipate, predict, potential, continue, or similar expressions. You may find some of th statements in this report. These forward-looking statements are not historical facts and are inherently uncertain and outside of our control. Any or all of our forward-looking statements in this report may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this report will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially. Factors that may cause our plans, expectations, future financial condition and results to change are described throughout this report and in our Annual Report on Form 10-K, particularly in *Risk Factors*, Part I, Item 1A of that report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At September 30, 2007, we had borrowings of $529.0 million under our senior credit facility with fluctuating interest rates based on market benchmarks such as LIBOR. For our variable-rate debt, changes in interest rates generally do not affect the fair market value, but do impact earnings and cash flow. To reduce the risk of increasing interest rates, we entered into $325.0 million of interest rate swap agreements. Currently, we have entered into the following interest rate swap agreements:

Fixed interest rate	4.07%	3.98%	5.51%	4.95%	5.34%
Notional amount (in millions)	$50.0	$50.0	$50.0	$75.0	$100.0
Effective date	5/26/2005	6/2/2005	6/20/2006	4/30/2007	6/11/2007
Expiration date	5/26/2008	5/31/2008	6/30/2009	4/30/2009	12/31/2009
Counterparties	Goldman Sachs	Wells Fargo	Goldman Sachs	Wells Fargo	Goldman Sachs

These interest rate swap agreements have the effect of reducing the amount of our debt exposed to variable interest rates from $529.0 million to $204.0 million. For the 12-month period ending September 30, 2008, for every 1.0% increase in LIBOR we will pay an additional $2.4 million in interest expense and for every 1.0% decrease in LIBOR we will save $2.4 million in interest expense.

We may consider entering into additional interest rate strategies. However, we have not yet determined what those strategies may be or their possible impact.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer, based on their evaluation as of the end of the period covered by this Form 10-Q, concluded that our disclosure

Table of Contents

controls and procedures are effective in timely alerting them to information we are required to include in our periodic reports filed with the SEC.

During our most recent fiscal quarter, there were no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not subject to any legal proceedings other than ordinarily routine litigation incidental to the conduct of our business.

ITEM 1A. RISK FACTORS

For information regarding risk factors, please refer to Item 1A in our 2006 Annual Report on Form 10-K. There have not been any material changes in the risk factors disclosed in our 2006 Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on November 6, 2007.

Date: November 6, 2007

By: /s/ Tomas W. Fuller

Tomas W. Fuller
Chief Financial Officer

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
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31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.