

VCA ANTECH INC  
Form 10-Q  
May 07, 2010

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

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2010**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File Number: 001-16783**

**VCA Antech, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**95-4097995**

(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  No .

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). (Not yet applicable to the registrant)

Yes  No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.:

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No .

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, 85,960,877 shares as of May 4, 2010.



**VCA Antech, Inc.**  
**Form 10-Q**  
**March 31, 2010**  
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**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)**

<b>Assets</b>	<b>March 31, 2010</b>	<b>December 31, 2009</b>
Current assets:		
Cash and cash equivalents	\$ 178,197	\$ 145,181
Trade accounts receivable, less allowance for uncollectible accounts of \$13,036 and \$13,015 at March 31, 2010 and December 31, 2009, respectively	54,276	49,186
Inventory	32,489	32,031
Prepaid expenses and other	24,516	27,242
Deferred income taxes	18,797	18,318
Prepaid income taxes		6,252
Total current assets	308,275	278,210
Property and equipment, less accumulated depreciation and amortization of \$175,768 and \$167,506 at March 31, 2010 and December 31, 2009, respectively	298,840	289,415
Goodwill	995,123	985,674
Other intangible assets, net	43,345	44,280
Notes receivable, net	5,662	5,153
Deferred financing costs, net	449	581
Other	25,991	24,091
Total assets	\$ 1,677,685	\$ 1,627,404
<b>Liabilities and Equity</b>		
Current liabilities:		
Current portion of long-term debt	\$ 8,721	\$ 17,195
Accounts payable	30,333	28,326
Accrued payroll and related liabilities	43,493	33,539
Income taxes payable	6,514	
Other accrued liabilities	40,541	43,298
Total current liabilities	129,602	122,358
Long-term debt, less current portion	525,558	527,860
Deferred income taxes	85,640	75,197
Other liabilities	10,422	10,651
Total liabilities	751,222	736,066
Commitments and contingencies		

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Preferred stock, par value \$0.001, 11,000 shares authorized, none outstanding

VCA Antech, Inc. stockholders' equity:

Common stock, par value \$0.001, 175,000 shares authorized, 85,918 and 85,584 shares outstanding as of March 31, 2010 and December 31, 2009, respectively

	86	86
Additional paid-in capital	337,569	335,114
Accumulated earnings	571,945	540,010
Accumulated other comprehensive income (loss)	347	(163)
Total VCA Antech, Inc. stockholders' equity	909,947	875,047
Noncontrolling interest	16,516	16,291
Total equity	926,463	891,338
Total liabilities and equity	\$ 1,677,685	\$ 1,627,404

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

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Revenue	\$ 330,734	\$ 315,850
Direct costs	247,939	233,681
Gross profit	82,795	82,169
Selling, general and administrative expense	26,140	22,917
Loss (gain) on sale and disposal of assets	25	(248)
Operating income	56,630	59,500
Interest expense, net	3,167	6,118
Other expense (income)	25	(110)
Income before provision for income taxes	53,438	53,492
Provision for income taxes	20,506	20,611
Net income	32,932	32,881
Net income attributable to noncontrolling interests	997	911
Net income attributable to VCA Antech, Inc.	\$ 31,935	\$ 31,970
Basic earnings per share	\$ 0.37	\$ 0.38
Diluted earnings per share	\$ 0.37	\$ 0.37
Weighted-average shares outstanding for basic earnings per share	85,824	84,680
Weighted-average shares outstanding for diluted earnings per share	86,870	85,386

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 Equity  
(Unaudited)  
(In thousands)**

	Common Stock		Additional	Accumulated	Accumulated Other	Noncontrolling	Total
	Shares	Amount	Paid-In Capital	Earnings	Comprehensive (Loss) Income	Interests	
Balances, December 31, 2008	84,633	\$ 85	\$ 308,674	\$ 408,582	\$ (6,352)	\$ 12,846	\$ 723,835
Net income				31,970		911	32,881
Foreign currency translation adjustment					(178)		(178)
Unrealized loss on foreign currency, net of tax					(58)		(58)
Unrealized loss on hedging instruments, net of tax					(374)		(374)
Losses on hedging instruments reclassified to income, net of tax					1,976		1,976
Formation of noncontrolling interest						3,440	3,440
Distribution to noncontrolling interest						(888)	(888)
Share-based compensation			1,976				1,976
Issuance of common stock under stock option plans	71		557				557
Stock repurchases			(180)				(180)
Tax shortfall from stock options and awards			(245)				(245)
Balances, March 31, 2009	84,704	85	310,782	440,552	(4,986)	16,309	762,742
Balances, December 31, 2009	85,584	\$ 86	\$ 335,114	\$ 540,010	\$ (163)	\$ 16,291	\$ 891,338



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Net income			31,935			997	32,932
Foreign currency translation adjustment				167			167
Unrealized gain on foreign currency, net of tax				111			111
Unrealized loss on hedging instruments, net of tax				(1)			(1)
Losses on hedging instruments reclassified to income, net of tax				233			233
Formation of noncontrolling interest						450	450
Distribution to noncontrolling interest						(989)	(989)
Purchase of noncontrolling interest						(233)	(233)
Share-based compensation		2,088					2,088
Issuance of common stock under stock option plans	334		2,858				2,858
Stock repurchases			(2,253)				(2,253)
Tax shortfall from stock options and awards			(238)				(238)
Balances, March 31, 2010	85,918	\$ 86	\$ 337,569	\$ 571,945	\$ 347	\$ 16,516	\$ 926,463

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)**

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Cash flows from operating activities:		
Net income	\$ 32,932	\$ 32,881
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,707	9,152
Amortization of debt issue costs	132	120
Provision for uncollectible accounts	1,492	1,559
Loss (gain) on sale and disposal of assets	25	(248)
Share-based compensation	2,088	1,976
Deferred income taxes	7,232	5,304
Excess tax benefit from exercise of stock options	(264)	
Other	(114)	(148)
Changes in operating assets and liabilities:		
Accounts receivable	(6,511)	(5,455)
Inventory, prepaid expenses and other assets	644	(2,790)
Accounts payable and other accrued liabilities	(288)	(2,362)
Accrued payroll and related liabilities	9,954	(3,204)
Income taxes	12,527	14,413
Net cash provided by operating activities	70,556	51,198
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(9,247)	(14,467)
Real estate acquired in connection with business acquisitions	(1,300)	(963)
Property and equipment additions	(16,049)	(12,886)
Proceeds from sale of assets	6	74
Other	(61)	(373)
Net cash used in investing activities	(26,651)	(28,615)
Cash flows from financing activities:		
Repayment of debt	(10,822)	(1,946)
Distributions to noncontrolling interest partners	(989)	(888)
Proceeds from issuance of common stock under stock option plans	2,858	557
Excess tax benefit from exercise of stock options	264	
Stock repurchases	(2,253)	(180)
Net cash used in financing activities	(10,942)	(2,457)
Effect of currency exchange rate changes on cash and cash equivalents	53	(1)

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Increase in cash and cash equivalents	33,016	20,125
Cash and cash equivalents at beginning of period	145,181	88,959
Cash and cash equivalents at end of period	\$ 178,197	\$ 109,084
Supplemental disclosures of cash flow information:		
Interest paid	\$ 3,196	\$ 6,430
Income taxes paid	\$ 747	\$ 894
Supplemental schedule of noncash investing and financing activities:		
Detail of acquisitions:		
Fair value of assets acquired	\$ 8,868	\$ 23,333
Cash paid for acquisitions	(8,528)	(13,095)
Noncash note conversion to equity interest in subsidiary		(5,700)
Contingent consideration	(7)	
Liabilities assumed	\$ 333	\$ 4,538

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

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**VCA Antech, Inc. and Subsidiaries**  
**Notes to Condensed, Consolidated Financial Statements**  
**March 31, 2010**  
**(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: animal hospitals ( Animal Hospital ), veterinary diagnostic laboratories ( Laboratory ) and veterinary medical technology ( Medical Technology ).

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 March 31, 2010, we operated 492 animal hospitals throughout 40 states.

We operate a full-service veterinary diagnostic laboratory network serving all 50 states and certain areas in Canada. 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 March 31, 2010, we operated 47 laboratories of various sizes located strategically throughout the United States and Canada.

Our Medical Technology segment sells digital radiography and ultrasound imaging equipment, provides education and training on the use of that equipment, provides consulting and mobile imaging services, and sells software and ancillary services to the veterinary market.

**2. Basis of Presentation**

Our accompanying unaudited, condensed, consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ( GAAP ) for interim financial information and in accordance with the rules and regulations of the United States Securities and Exchange Commission ( SEC ). Accordingly, they do not include all of the information and notes required by GAAP 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 months ended March 31, 2010 are not necessarily indicative of the results to be expected for the full year ending December 31, 2010. For further information, refer to our consolidated financial statements and notes thereto included in our 2009 Annual Report on Form 10-K.

Certain reclassifications have been made herein to 2009 amounts to conform to the current year presentation. During the quarter we reclassified certain business operations from our Medical Technology segment to our Laboratory segment; the reclassifications did not have a material impact on either of our segments.

The preparation of our condensed, consolidated financial statements in accordance with GAAP 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. Multiple-Deliverable Revenue Arrangements**

In October 2009, the FASB issued new accounting guidance related to multiple-deliverable revenue arrangements. The new guidance was designed to result in financial reporting that better reflects the underlying economics of multiple-deliverable transactions. We early adopted the new guidance on January 1, 2010, which resulted in the more timely recognition of revenue in our Medical Technology business segment. The early adoption resulted in the recognition of \$1.1 million in incremental revenue during the quarter in comparison to the revenue that would have been recognized under previous accounting guidance.

**Table of Contents****VCA Antech, Inc. and Subsidiaries****Notes to Condensed, Consolidated Financial Statements (Continued)****3. Multiple-Deliverable Revenue Arrangements, continued**

Our Medical Technology business segment sells Digital Radiography ( DR ) imaging equipment to end users and to distributors in international markets which includes receptor plates, related computer equipment, software and additional related equipment, with one year of warranty support on the receptor plates and items related to the plates, and technical support on all software provided with the equipment. Distributors sell the DR products and warranties to the end customers and are responsible for all support provided directly to the end customer. The support that we provide to distributors is limited to the machines that are under a current support program and includes a level of warranty coordination, support and facilitation, including technical support related to the receptor plates, and receptor plate replacement during warranty repair ensuring limited down time to the end customer.

Under the new accounting guidance, sales arrangement consideration is allocated at the inception of the arrangement to all deliverables using the relative selling price method, whereby any discount in the arrangement is allocated proportionally to each deliverable on the basis of each deliverable's selling price. The selling price for each deliverable is based on vendor-specific objective evidence ( VSOE ) if available, third-party evidence ( TPE ) if VSOE is not available, or estimated selling price ( ESP ) if neither VSOE nor TPE is available. For elements where VSOE is available, VSOE of fair value is based on the price for those products and services when sold separately by us or the price established by management with the relevant authority. TPE of selling price is the price of our, or any of our competitor's, largely interchangeable products or services in stand-alone sales to similarly situated customers.

We do not currently have VSOE for our DR imaging equipment as units are not sold on a stand-alone basis without the related support packages. As this is also true for our competitors, TPE of selling price is also unavailable. We therefore use the ESP to allocate the arrangement consideration related to our DR imaging equipment. Our ESP was based upon the actual selling price of our DR equipment bundled with our Sound Assurance warranty. We calculated the stand-alone selling price of the DR equipment using a cost plus margin approach. The stand-alone cost in most cases was determined using manufacturer data. The margin however was based upon the amount received on the actual sale of the bundled product, which does not differ materially from the margin exclusive of the post-contract customer support ( PCS ). By utilizing this cost plus actual margin method we were able to incorporate both our internal pricing strategies in addition to external market conditions.

In domestic markets we have VSOE for our PCS as the support package is sold on a stand-alone basis. Our PCS agreements normally include a warranty on the receptor plate and technical support on the software elements. In foreign markets however, we do not have VSOE on the receptor plate warranties. Accordingly we use a similar cost plus margin approach to determine the ESP.

Also in international markets revenue is recognized on the DR equipment upon delivery to the distributor and distributor acceptance. After the DR equipment is delivered there may be a delay as to when the warranty and software PCS period starts as the terms of the arrangement state that the PCS period starts the earlier of the date the DR equipment is delivered to the end user or three months after the DR equipment was delivered to the distributor, as such revenue recognition for the equipment does not start until the PCS period starts. Revenue for the warranty and software PCS is recognized on a straight-line basis over the PCS period.

The changes made under the new accounting guidance did not cause any changes in the units of accounting related to our arrangements.

The new guidance resulted in a different allocation of revenue to the deliverables in the current fiscal year, which changed the pattern and timing of revenue recognition for these elements but did not change the total revenue to be recognized for the arrangement. Revenue and gross profit increased by \$1.1 million and \$280,000, respectively, for the period ending March 31, 2010. The primary driver of the impact was the acceleration of revenue related to the delivery of the equipment in international markets, which under the previous accounting guidance was deferred over the PCS period as we were unable to establish VSOE for the undelivered elements.

We are not able to reasonably estimate the effect of adopting these standards on future financial periods as the impact will vary based on the nature and volume of new or materially modified arrangements in any given period.



**Table of Contents****VCA Antech, Inc. and Subsidiaries****Notes to Condensed, Consolidated Financial Statements (Continued)****4. Goodwill and Other Intangible Assets****Goodwill**

Goodwill represents the excess of the aggregate of the consideration transferred, the fair value of any noncontrolling interest in the acquiree and for a business combination achieved in stages, the acquisition-date fair value of any previously held equity interest 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 three months ended March 31, 2010 (in thousands):

	<b>Animal Hospital</b>	<b>Laboratory</b>	<b>Medical Technology</b>	<b>Total</b>
Balance as of December 31, 2009	\$ 861,868	\$ 96,285	\$ 27,521	\$ 985,674
Goodwill acquired	7,069	7		7,076
Other <sup>(1)</sup>	(157)	388	2,142	2,373
Balance as of March 31, 2010	\$ 868,780	\$ 96,680	\$ 29,663	\$ 995,123

<sup>(1)</sup> Other includes purchase-price adjustments which consist primarily of an adjustment to the valuation of deferred tax assets, buy-outs, earn-out payments and foreign currency translation adjustments.

**Other Intangible Assets**

In addition to goodwill, we have amortizable intangible assets at March 31, 2010 and December 31, 2009 as follows (in thousands):

	<b>As of March 31, 2010</b>			<b>As of December 31, 2009</b>		
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount</b>
Noncontractual customer relationships	\$ 39,483	\$ (9,425)	\$ 30,058	\$ 38,359	\$ (8,077)	\$ 30,282
Covenants not-to-compete	14,163	(7,659)	6,504	14,748	(7,785)	6,963
Favorable lease asset	5,406	(2,277)	3,129	5,406	(2,150)	3,256
Trademarks	3,379	(598)	2,781	3,362	(494)	2,868
Technology	2,209	(1,366)	843	2,209	(1,332)	877
Client lists	48	(18)	30	60	(26)	34

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Total	\$ 64,688	\$ (21,343)	\$ 43,345	\$ 64,144	\$ (19,864)	\$ 44,280
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The following table summarizes our aggregate amortization expense related to other intangible assets (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Aggregate amortization expense	\$ 2,154	\$ 1,807



**Table of Contents****VCA Antech, Inc. and Subsidiaries****Notes to Condensed, Consolidated Financial Statements (Continued)****4. Goodwill and Other Intangible Assets, continued**

The estimated amortization expense related to intangible assets for the remainder of 2010 and each of the succeeding years thereafter as of March 31, 2010 is as follows (in thousands):

Remainder of 2010	\$ 6,735
2011	8,199
2012	7,204
2013	5,084
2014	2,841
Thereafter	13,282
Total	\$ 43,345

**5. Other Accrued Liabilities**

Other accrued liabilities consisted of the following (in thousands):

	<b>March 31, 2010</b>	<b>December 31, 2009</b>
Deferred revenue	\$ 11,321	\$ 12,497
Accrued health insurance	4,745	4,484
Deferred rent	3,022	2,989
Accrued workers compensation insurance	2,385	2,217
Customer deposits	2,157	3,783
Other	16,911	17,328
	\$ 40,541	\$ 43,298

**6. Interest Rate Swap Agreements**

In accordance with current accounting guidance, all investments in derivatives are recorded at fair value. A derivative is typically defined as an instrument whose value is derived from an underlying instrument, index or rate, has a notional amount, requires little or no initial investment and can be net settled. Our derivatives are reported as current assets and liabilities or other non-current assets or liabilities as appropriate.

We use interest rate swap agreements to mitigate our exposure to increasing interest rates as well as to maintain an appropriate mix of fixed-rate and variable-rate debt.

If we determine that contracts are effective at meeting our risk reduction and correlation criteria we account for them using hedge accounting. Under hedge accounting, we recognize the effective portion of changes in the fair value of the contracts in other comprehensive income and the ineffective portion in earnings. If we determine that contracts do not, or no longer, meet our risk reduction and correlation criteria, we account for them under a fair-value method recognizing changes in the fair value in earnings in the period of change. If we determine that a contract no longer meets our risk reduction and correlation criteria, or if the derivative expires, we recognize in earnings any accumulated balance in other comprehensive income related to the contract in the period of determination. For interest rate swap agreements accounted for under hedge accounting, we assess the effectiveness based on changes in their intrinsic value with changes in the time value portion of the contract reflected in earnings. All cash payments made or received under the contracts are recognized in interest expense.

Credit exposure associated with nonperformance by the counterparties to derivative instruments is generally limited to the uncollateralized fair value of the asset related to instruments recognized in the consolidated balance

sheets. We attempt to mitigate the risk of nonperformance by selecting counterparties with high credit ratings and monitoring their creditworthiness and by diversifying derivative amounts with multiple counterparties.

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

**6. Interest Rate Swap Agreements, continued**

The contractual or notional amounts for derivatives are used to calculate the exchange of contractual payments under the agreements and are not representative of the potential for gain or loss on these instruments. Interest rates affect the fair value of derivatives. The fair values generally represent the estimated amounts that we would expect to receive or pay upon termination of the contracts at the reporting date. The fair values are based upon dealer quotes when available or an estimate using values obtained from independent pricing services, costs to settle or quoted market prices of comparable instruments.

As of the quarter ended March 31, 2010, all of our interest rate swap agreements have expired.

The following table summarizes cash received or cash paid and ineffectiveness reported in earnings as a result of our interest rate swap agreements (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2010</b>	<b>2009</b>
Cash paid <sup>(1)</sup>	\$ 382	\$ 3,245
Recognized gain from ineffectiveness <sup>(2)</sup>	\$	\$ (49)

(1) Our interest rate swap agreements effectively converted a certain amount of our variable-rate debt under our senior credit facility to fixed-rate for purposes of hedging against the risk of increasing interests rates. The above table depicts cash payments to the counterparties on our swap agreements. These payments and receipts are offset by a corresponding decrease or increase in interest paid on

our variable-rate debt under our senior credit facility. These amounts are included in interest expense, net in our condensed, consolidated income statements.

- (2) The recognized gain is included in other income in our condensed, consolidated income statements.

#### **7. Fair Value Measurements**

Current fair value accounting guidance includes a hierarchy that is intended to increase consistency and comparability in fair value measurements and related disclosures. The fair value hierarchy is based on inputs to valuation techniques that are used to measure fair value that are either observable or unobservable. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon their own market assumptions. The current guidance establishes a three-tiered fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

*Level 1.* Observable inputs such as quoted prices in active markets;

*Level 2.* Inputs, other than quoted prices, that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active; and

*Level 3.* Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

**Table of Contents****VCA Antech, Inc. and Subsidiaries****Notes to Condensed, Consolidated Financial Statements (Continued)****7. Fair Value Measurements, continued***Fair Value of Financial Instruments*

The FASB accounting guidance requires disclosure of fair value information about financial instruments, whether or not recognized in the accompanying condensed, consolidated balance sheets. Fair value as defined by the guidance is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value estimates of financial instruments are not necessarily indicative of the amounts we might pay or receive in actual market transactions. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

*Cash and Cash Equivalents.* These balances include cash and cash equivalents with maturities of less than three months. The carrying amount approximates fair value due to the short-term maturities of these instruments.

*Receivables, Less Allowance for Doubtful Accounts, Accounts Payable and Certain Other Accrued Liabilities.* Due to their short-term nature, fair value approximates carrying value.

*Long-Term Debt.* We believe the carrying values of our variable-rate debt at March 31, 2010 and December 31, 2009 are not reasonable estimates of fair value due to changes in the credit markets during 2009 and 2010. We have estimated the fair value of our variable-rate debt using discounted cash flow techniques utilizing current market rates, which incorporate our credit risk.

The following table reflects the carrying value and fair value of our long-term debt (in thousands):

	<b>As of March 31, 2010</b>		<b>As of December 31, 2009</b>	
	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Carrying Value</b>	<b>Fair Value</b>
Variable-rate long-term debt	\$ 506,773	\$ 504,919	\$ 516,889	\$ 513,053

*Interest Rate Swap Agreements.* We use the market approach to measure fair value for our interest rate swap agreements. The market approach uses prices and other relevant information generated by market transactions involving comparable assets or liabilities.

The following table reflects the fair value of our interest rate swap agreements, which is measured on a recurring basis as defined by the FASB accounting guidance (in thousands):

	<b>Balance</b>	<b>Basis of Fair Value Measurement</b>		
		<b>Quoted Prices In Active Markets for Identical Items (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
At December 31, 2009				
Other accrued liabilities	\$ 380	\$	\$ 380	\$

As of March 31, 2010, we do not have any applicable non-recurring measurements of non-financial assets and non-financial liabilities.

**Table of Contents****VCA Antech, Inc. and Subsidiaries****Notes to Condensed, Consolidated Financial Statements (Continued)****8. Share-Based Compensation****Stock Option Activity**

A summary of our stock option activity for the three months ended March 31, 2010 is as follows (in thousands):

	<b>Stock Options</b>	<b>Weighted- Average Exercise Price</b>
Outstanding at January 1, 2010	4,300	\$ 16.72
Exercised	(173)	16.47
Outstanding at March 31, 2010	4,127	\$ 16.73
Exercisable at March 31, 2010	3,377	\$ 16.66
Expected to vest at March 31, 2010	716	\$ 17.04

There were no stock options granted during the three months ended March 31, 2010. The aggregate intrinsic value of our stock options exercised during the three months ended March 31, 2010 was \$1.6 million, and the actual tax benefit realized on options exercised during the period was \$607,000.

At March 31, 2010 there was \$3.6 million of total unrecognized compensation cost related to our stock options. This cost is expected to be recognized over a weighted-average period of 1.9 years.

The compensation cost that has been charged against income for stock options for the three months ended March 31, 2010 and 2009 was \$471,000 and \$507,000, respectively. The corresponding income tax benefit recognized was \$183,000 and \$198,000 for the three months ended March 31, 2010 and 2009, respectively.

**Nonvested Stock Activity**

During the three months ended March 31, 2010 there were no grants of nonvested common stock.

Total compensation cost charged against income related to nonvested stock awards was \$1.6 million and \$1.5 million for the three months ended March 31, 2010 and 2009, respectively. The corresponding income tax benefit recognized in the income statement was \$629,000 and \$574,000 for the three months ended March 31, 2010 and 2009, respectively.

At March 31, 2010, there was \$8.3 million of unrecognized compensation cost related to these nonvested shares, which will be recognized over a weighted-average period of 2.1 years. A summary of our nonvested stock activity for the three months ended March 31, 2010 is as follows:

	<b>Shares</b>	<b>Weighted- Average Fair Value Per Share</b>
Outstanding at December 31, 2009	691,764	\$ 30.54
Granted		
Vested	(250,154)	\$ 31.71
Forfeited/Canceled	(8,630)	\$ 30.35

Outstanding at March 31, 2010	432,980	\$	29.87
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**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 the 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 the period. Basic and diluted earnings per share were calculated as follows (in thousands, except per share amounts):

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Net income attributable to VCA Antech, Inc.	\$ 31,935	\$ 31,970
Weighted-average common shares outstanding:		
Basic	85,824	84,680
Effect of dilutive potential common shares:		
Stock options	870	568
Nonvested shares	176	138
Diluted	86,870	85,386
Basic earnings per share	\$ 0.37	\$ 0.38
Diluted earnings per share	\$ 0.37	\$ 0.37

For the three months ended March 31, 2010 and 2009, potential common shares of 79,918 and 2,417,761, respectively, were excluded from the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

**10. Comprehensive Income**

Total comprehensive income consists of net income and the other comprehensive income during the three months ended March 31, 2010 and 2009. The following table provides a summary of comprehensive income (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Net income	\$ 32,932	\$ 32,881
Other comprehensive income:		
Foreign currency translation adjustments	167	(178)
Unrealized gain (loss) on foreign currency	182	(95)
Tax (expense) benefit	(71)	37
Unrealized loss on hedging instruments	(2)	(614)
Tax benefit	1	240
Losses on hedging instruments reclassified to income	382	3,245
Tax benefit	(149)	(1,269)
Other comprehensive income	510	1,366



Total comprehensive income	33,442	34,247
Comprehensive income attributable to noncontrolling interests	(997)	(911)
Comprehensive income attributable to VCA Antech, Inc.	\$ 32,445	\$ 33,336

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

**11. Lines of Business**

Our reportable segments are Animal Hospital, Laboratory 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 Animal Hospital segment provides veterinary services for companion animals and sells related retail and pharmaceutical products. Our Laboratory segment provides diagnostic laboratory testing services for veterinarians, both associated with our animal hospitals and those independent of us. 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 essentially the same as those described in the summary of significant accounting policies included in our 2009 Annual Report on Form 10-K. See Note 3, *Multiple-Deliverable Revenue Arrangements*, for an update on our revenue recognition policies as a result of implementing the FASB's accounting guidance on multiple-deliverable revenue arrangements. 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 generally 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)****11. Lines of Business, continued**

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

	<b>Animal Hospital</b>	<b>Laboratory<sup>(1)</sup></b>	<b>Medical Technology<sup>(1)</sup></b>	<b>Corporate</b>	<b>Intercompany Eliminations</b>	<b>Total<sup>(1)</sup></b>
<b>Three Months Ended March 31, 2010</b>						
External revenue	\$ 246,668	\$ 69,400	\$ 14,666	\$	\$	\$ 330,734
Intercompany revenue		8,780	1,131		(9,911)	
Total revenue	246,668	78,180	15,797		(9,911)	330,734
Direct costs	204,991	41,652	10,966		(9,670)	247,939
Gross profit	41,677	36,528	4,831		(241)	82,795
Selling, general and administrative expense	5,587	6,154	3,515	10,884		26,140
Net (gain) loss on sale and disposal of assets	(16)	1	40			25
Operating income (loss)	\$ 36,106	\$ 30,373	\$ 1,276	\$ (10,884)	\$ (241)	\$ 56,630
Depreciation and amortization	\$ 7,352	\$ 2,413	\$ 601	\$ 581	\$ (240)	\$ 10,707
Capital expenditures	\$ 13,128	\$ 832	\$ 82	\$ 2,327	\$ (320)	\$ 16,049
<b>Three Months Ended March 31, 2009</b>						
External revenue	\$ 238,358	\$ 69,713	\$ 7,779	\$	\$	\$ 315,850
Intercompany revenue		8,149	1,006		(9,155)	
Total revenue	238,358	77,862	8,785		(9,155)	315,850
Direct costs	195,194	41,831	5,557		(8,901)	233,681
Gross profit	43,164	36,031	3,228		(254)	82,169
Selling, general and administrative expense	5,384	5,567	2,812	9,154		22,917
Net (gain) loss on sale and disposal of assets	(259)	2	1	8		(248)
Operating income (loss)	\$ 38,039	\$ 30,462	\$ 415	\$ (9,162)	\$ (254)	\$ 59,500
Depreciation and amortization	\$ 6,299	\$ 2,195	\$ 357	\$ 488	\$ (187)	\$ 9,152

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Capital expenditures	\$ 9,123	\$ 2,129	\$ 1,121	\$ 885	\$ (372)	\$ 12,886
<b>At March 31, 2010</b>						
Total assets	\$ 1,173,654	\$ 210,394	\$ 71,238	\$ 233,855	\$ (11,456)	\$ 1,677,685
<b>At December 31, 2009</b>						
Total assets	\$ 1,158,891	\$ 207,043	\$ 71,019	\$ 201,024	\$ (10,573)	\$ 1,627,404

(1) Certain prior year amounts have been reclassified to reflect the transfer of certain business operations to the Laboratory segment from the Medical Technology segment. The reclassifications did not have a material impact on either of our segments.

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**VCA Antech, Inc. and Subsidiaries**

**Notes to Condensed, Consolidated Financial Statements (Continued)**

**12. Commitments and Contingencies**

We have certain commitments, including operating leases and purchase agreements. These items are discussed in detail in our consolidated financial statements and notes thereto included in our 2009 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 that were accounted for under previous business combinations accounting guidance, 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 criteria is established. If the specified financial criteria are attained, at March 31, 2010, we will be obligated to pay an additional \$1.7 million. We adopted new accounting guidance regarding business combinations for acquisitions with acquisition dates of January 1, 2009 or later. Under the new guidance contingent consideration, such as earn-out liabilities, is now recognized as part of the consideration transferred on the acquisition date and a corresponding liability is recorded based on the fair value of the liability. The changes in fair value are recognized in earnings where applicable at each reporting period.

***b. Other Contingencies***

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

In the fourth quarter of 2009, we received correspondence from the state of New York which included a proposed assessment of taxes payable related to our reported taxable income for the tax years from 2004 through 2006. We have evaluated the proposal and have determined that it is more likely than not that our position will be upheld.

**13. Subsequent Events**

On April 8, 2010, pursuant to our warrant agreement we purchased 34% of the outstanding stock of Strategic Pharmaceutical Solutions, Inc. ( Vet Source ) for \$1.0 million. We anticipate that this investment will be accounted for in accordance with the equity method of accounting which involves recording 34% of the net income or loss of Vet Source at each reporting period. In addition, we entered into a consulting agreement whereby VCA will receive a fee of \$1.0 million for advisory services to be provided to Vet Source management over the remainder of the 2010 fiscal year.

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

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**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, may, 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 May 7, 2010, and we undertake no duty to update this information. Shareholders and prospective investors can find information filed with the SEC after May 7, 2010 at our website at <http://investor.vcaantech.com> or at the SEC's website at [www.sec.gov](http://www.sec.gov).*

We are a leading national animal healthcare company. We provide 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 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 March 31, 2010, our animal hospital network consisted of 492 animal hospitals in 40 states.

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 March 31, 2010, our Laboratory network consisted of 47 laboratories serving all 50 states and certain areas in Canada.

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.

Our revenue has been adversely impacted by the current economic recession. We are unable to forecast the timing or degree of any economic recovery. Further, trends in the general economy may not be reflected in our business at the same time or in the same degree as in the general economy. The timing and degree of any economic recovery, and its impact on our business, are among the important factors that could cause our actual results to differ from our forward-looking information.

**Table of Contents****Executive Overview**

During the three months ended March 31, 2010 we experienced relative improvement in our revenue growth rate in comparison to previous quarters. We continued to recover from the effects of the economic recession; however, we were confronted by record adverse weather conditions throughout certain parts of the country which impacted both our Animal Hospital and Laboratory revenues. Although our Animal Hospital same-store revenue declined, we achieved an increase in consolidated revenue through selective animal hospital acquisitions. We also experienced substantial growth in our Medical Technology segment partially related to the expansion of our business as a result of the acquisition of Eklin. Overall economic conditions and adverse weather resulted in declines in our operating income. Our overall earnings were flat in comparison to the prior year.

***Acquisitions and Facilities***

Our growth strategy includes the acquisition of independent animal hospitals. We currently anticipate that we will acquire \$50.0 million to \$60.0 million of annualized Animal Hospital revenue by the end of 2010. In addition, we also evaluate the acquisition of animal hospital chains, laboratories, or related businesses if favorable opportunities are presented. The following table summarizes the changes in the number of facilities operated by our Animal Hospital and Laboratory segments during the three months ended March 31, 2010:

**Animal Hospitals:**

Beginning of period	489
Acquisitions	4
Sold, closed or merged	(1)
End of period	492

**Laboratories:**

Beginning of period	47
Acquisitions	
Acquisitions relocated into our existing laboratories	(1)
Created	1
End of period	47

The following table summarizes the aggregate consideration for the four animal hospitals acquired during the three months ended March 31, 2010, and the allocation of the purchase price (in thousands):

**Consideration:**

Cash <sup>(1)</sup>	\$ 8,528
Contingent consideration	7
Fair value of total consideration transferred	\$ 8,535

**Allocation of the Purchase Price:**

Tangible assets	\$ 584
Identifiable intangible assets	1,208
Goodwill <sup>(2)</sup>	7,076
Other liabilities assumed	(333)
Total	\$ 8,535



- (1) See the *Cash Flows from Investing Activities* section in the Liquidity and Capital Resources discussion for reconciliation of cash paid for acquisitions per this schedule to the condensed, consolidated statement of cash flows.
- (2) We expect that \$7.1 million of the goodwill recorded for these acquisitions as of March 31, 2010 will be fully deductible for income tax purposes.

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In addition to the purchase price listed above, we made cash payments for real estate acquired in connection with our purchase of animal hospitals totaling \$1.3 million for the three months ended March 31, 2010.

**Acquisition of Eklin Medical Systems, Inc.**

On July 1, 2009, we acquired Eklin, a leading seller of digital radiography and ultrasound systems in the veterinary market. We acquired Eklin for a purchase price of \$12.5 million, net of cash acquired of \$1.0 million. The following table summarizes the consideration and allocation of the purchase price (in thousands):

**Consideration:**

Cash	\$ 12,504
Fair value of total consideration transferred	\$ 12,504

**Allocation of the Purchase Price:**

Tangible assets	\$ 6,830
Identifiable intangible assets	7,351
Goodwill <sup>(1)</sup>	10,875
Other liabilities assumed	(12,552)
Total	\$ 12,504

<sup>(1)</sup> We expect that \$3.4 million of the goodwill recorded for this acquisition as of March 31, 2010 will be fully deductible for income tax purposes.

Eklin has been combined with Sound Technologies, Inc. ( STI ) and is reported within our Medical Technology segment.

The pro forma impacts on revenue and earnings have not been disclosed for the current or comparable prior periods as the amounts were immaterial to the financial statements as a whole.

**Critical Accounting Policies**

Our consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ( GAAP ), 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 revenue recognition, valuation of goodwill and other intangible assets, income taxes, and self-insured liabilities can be found in our 2009 Annual Report on Form 10-K. During the quarter ended March 31, 2010, we implemented new accounting guidance related to multiple-deliverable revenue arrangements. Other than the changes to our revenue recognition policies there have been no other material changes to the policies noted above as of this quarterly report on Form 10-Q for the period ended March 31, 2010.



**Table of Contents*****Medical Technology Revenue***

We sell our digital radiography imaging equipment with multiple elements, including hardware, software, licenses and/or services. Under new accounting guidance, tangible products containing software components and nonsoftware components that function together to deliver the tangible product's essential functionality are now accounted for under the FASB's guidance pertaining to multiple-deliverable revenue arrangements. These types of arrangements were previously accounted for under software accounting guidance. Accordingly we now account for our digital radiography imaging equipment under this revised guidance.

Sales arrangement consideration is allocated at the inception of the arrangement to all deliverables using the relative selling price method, whereby any discount in the arrangement is allocated proportionally to each deliverable on the basis of each deliverable's selling price. The selling price for each deliverable is based on vendor-specific objective evidence ( VSOE ) if available, third-party evidence ( TPE ) if VSOE is not available, or estimated selling price ( ESP ) if neither VSOE nor TPE is available. For elements where VSOE is available, VSOE of fair value is based on the price for those products and services when sold separately by us or the price established by management with the relevant authority. TPE of selling price is the price of our, or any of our competitor's, largely interchangeable products or services in stand-alone sales to similarly situated customers. Our ESP was based upon the actual selling price of our DR equipment bundled with our Sound Assurance warranty. We calculated the stand-alone selling price of the DR equipment using a cost plus margin approach. The stand-alone cost in most cases was determined using manufacturer data. The margin however was based upon the amount received on the actual sale of the bundled product, which does not differ materially from the margin exclusive of the post-contract customer support ( PCS ). By utilizing this cost plus actual margin method we were able to incorporate both our internal pricing strategies in addition to external market conditions.

We do not currently have VSOE for our digital radiography imaging equipment as units are not sold on a stand-alone basis without support packages. As this is also true for our competitors, TPE of selling price is also unavailable. We therefore use the ESP to determine the selling price of our digital radiography imaging equipment using the methodology mentioned above. See Note 3, *Multiple-Deliverable Revenue Arrangements*, in our condensed, consolidated financial statements of this quarterly report on Form 10-Q for a more detailed discussion.

We recognize revenue when the services are provided or at the time of delivery or installation and customer acceptance. Generally, at the time of delivery and installation of equipment the only undelivered item is the PCS. This obligation is contractually defined in both terms of scope and period. For the PCS, we recognize the revenue for these services on a straight-line basis over the period of support and we expense the costs of these services as they are incurred.

**Table of Contents****Consolidated Results of Operations**

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Revenue:		
Animal Hospital	74.6%	75.5%
Laboratory	23.6	24.6
Medical Technology	4.8	2.8
Intercompany	(3.0)	(2.9)
Total revenue	100.0	100.0
Direct costs	75.0	74.0
Gross profit	25.0	26.0
Selling, general and administrative expense	7.9	7.2
Operating income	17.1	18.8
Interest expense, net	0.9	1.9
Income before provision for income taxes	16.2	16.9
Provision for income taxes	6.2	6.5
Net income	10.0	10.4
Net income attributable to noncontrolling interests	0.3	0.3
Net income attributable to VCA Antech, Inc.	9.7%	10.1%

**Revenue**

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

	<b>Three Months Ended March 31,</b>				
	<b>2010</b>		<b>2009</b>		
	<b>\$</b>	<b>% of Total</b>	<b>\$</b>	<b>% of Total</b>	<b>% Change</b>
Animal Hospital	\$ 246,668	74.6%	\$ 238,358	75.5%	3.5%
Laboratory <sup>(1)</sup>	78,180	23.6%	77,862	24.6%	0.4%
Medical Technology <sup>(1)</sup>	15,797	4.8%	8,785	2.8%	79.8%
Intercompany	(9,911)	(3.0)%	(9,155)	(2.9)%	8.3%
Total revenue	\$ 330,734	100.0%	\$ 315,850	100.0%	4.7%

(1) Prior year amounts have been adjusted to reflect the

reclassification  
of certain  
business  
operations from  
our Medical  
Technology  
segment to our  
Laboratory  
segment, (see  
Note 11, *Lines  
of Business*).  
The  
reclassification  
did not have a  
material impact  
on either  
segment.

Consolidated revenue increased \$14.9 million for the three months ended March 31, 2010 as compared to the same period in the prior year. The increase was primarily attributable to revenue from acquired animal hospitals and increased revenue from our Medical Technology business segment to some extent related to our ability to integrate the Eklin product line, partially offset by a decline in Animal Hospital same-store revenue of 1.6%.

**Table of Contents****Gross Profit**

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

	2010		2009		% Change
	\$	Gross Margin	\$	Gross Margin	
Animal Hospital	\$ 41,677	16.9%	\$ 43,164	18.1%	(3.4)%
Laboratory	36,528	46.7%	36,031	46.3%	1.4%
Medical Technology	4,831	30.6%	3,228	36.7%	49.7%
Intercompany	(241)		(254)		
Total gross profit	\$ 82,795	25.0%	\$ 82,169	26.0%	0.8%

Consolidated gross profit increased \$626,000 for the three months ended March 31, 2010 as compared to the same period in the prior year. The increase was primarily due to increased sales in our Medical Technology segment of digital radiography and ultrasound equipment partially offset by a decline in the gross profit margins due to a shift in product mix in that segment. The increase was also partially offset by a decline in both acquired and same-store Animal Hospital gross margins.

**Segment Results****Animal Hospital Segment**

The following table summarizes revenue, gross profit and gross margin for our Animal Hospital segment (in thousands, except percentages):

	2010		2009		% Change
	\$	%	\$	%	
Revenue	\$ 246,668		\$ 238,358		3.5%
Gross profit	\$ 41,677		\$ 43,164		(3.4)%
Gross margin		16.9%		18.1%	

Animal Hospital revenue increased \$8.3 million for the three months ended March 31, 2010 as compared to the same period in the prior year. The components of the increase are summarized in the following table (in thousands, except percentages and average revenue per order):

	2010		2009		% Change
	\$	%	\$	%	
Same-store facilities:					
Orders <sup>(1)</sup>	1,471		1,544		(4.7)%
Average revenue per order <sup>(2)</sup>	\$ 156.85		\$ 151.88		3.3%
Same-store revenue <sup>(1)</sup>	\$ 230,696		\$ 234,490		(1.6)%
Net acquired revenue <sup>(3)</sup>	15,972		3,868		
Total	\$ 246,668		\$ 238,358		3.5%

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- (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. Same-store revenue also includes revenue generated by customers referred from our relocated or combined animal hospitals, including those merged upon acquisition.
- (2) Computed by dividing same-store revenue by same-store orders. The average revenue per order may not calculate exactly due to rounding.
- (3) 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 January 1, 2009 for the three 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.

During the three months ended March 31, 2010 our volume of same-store orders declined due to the current economic environment further compounded by the adverse weather conditions on the East Coast during the first part of the year. In addition, some pet-related products traditionally sold in our animal hospitals are now widely available in retail stores and other distribution channels such as the Internet.

Our business strategy is to place a greater emphasis on comprehensive wellness visits and advanced medical procedures, which typically generate higher priced orders. The migration of lower priced orders from our animal hospitals to other distribution channels mentioned above and our emphasis on comprehensive wellness visits has resulted in a decrease in lower priced orders and an increase in higher priced orders. However, during the three months ended March 31, 2010 we experienced a decrease in the number of both lower and higher priced orders primarily as a result of current economic conditions and to a lesser extent the impact of changes in our overall business environment on the mix of tests performed.

Price increases also contributed to the increase in the average revenue per order. Prices at each of our animal hospitals are reviewed regularly and adjustments are made based on market considerations, demographics and our costs. These adjustments historically have approximated 3% to 6% on most services at the majority of our animal hospitals and are typically implemented in February of each year; however, during the quarter ended March 31, 2010 price adjustments were in the 2-3% range.

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 expenses, and costs of goods sold associated with the retail sales of pet food and pet supplies.

Our combined Animal Hospital gross margin decreased to 16.9% for the three months ended March 31, 2010 from 18.1% for the three months ended March 31, 2009. Our same-store gross margin decreased to 17.4% for the three months ended March 31, 2010 as compared to 18.3% for the comparable prior year period.

The decrease in same-store gross margin for the three months ended March 31, 2010 was attributable to the decline in same-store revenue, increases in certain labor costs, primarily payroll taxes, and overall increases in office and administration and depreciation and amortization expenses. The combined Animal Hospital gross margin was further impacted by the lower gross margins from our acquired animal hospitals.

Over the last several years we have acquired a significant number of animal hospitals. Many of these newly acquired animal hospitals had lower gross margins at the time of acquisition than those previously operated by us. We have improved these lower gross margins, in the aggregate, subsequent to the acquisition by improving animal hospital revenue, reducing costs and/or increasing operating leverage.

**Table of Contents****Laboratory Segment**

The following table summarizes revenue and gross profit for our Laboratory segment (in thousands, except percentages):

	<b>Three Months Ended March 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>% Change</b>
Revenue	\$ 78,180	\$ 77,862	0.4%
Gross profit	\$ 36,528	\$ 36,031	1.4%
Gross margin	46.7%	46.3%	

Laboratory revenue increased \$318,000 for the three months ended March 31, 2010 as compared to the same period in the prior year. The components of the increase in Laboratory revenue are detailed below (in thousands, except percentages and average revenue per requisition):

	<b>Three Months Ended March 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>% Change</b>
Internal growth:			
Number of requisitions <sup>(1)</sup>	3,206	3,275	(2.1)%
Average revenue per requisition <sup>(2)</sup>	\$ 24.33	\$ 23.77	2.4%
Total internal revenue <sup>(1)</sup>	\$ 77,997	\$ 77,862	0.2%
Acquired revenue <sup>(3)</sup>	183		
Total	\$ 78,180	\$ 77,862	0.4%

(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 them in the prior year and adjusted for the impact resulting from any differences in the number of billing days in

comparable periods.

- (2) Computed by dividing internal revenue by the number of requisitions.
- (3) Acquired revenue represents the revenue recognized from our acquired laboratories for the comparable current year period that we did not own them in the prior year.

The increase in Laboratory revenue for the three months ended March 31, 2010 was due to a slight increase in internal revenue as increases in average revenue per requisition were mostly offset by a decline in overall volume.

Requisitions from internal growth have been driven by an ongoing 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 animal hospitals. While these factors historically have resulted in significant increases in internal requisitions, the economic environment continues to impact requisitions.

The average revenue per requisition increased slightly for the three months ended March 31, 2010 as compared to prior year periods due to price increases which ranged from 3% to 4% in both February 2010 and February 2009. The price increases were largely offset by other factors including changes in the mix, performing lower-priced tests historically performed at the animal hospitals, and a decrease in higher-priced tests as a result of the current economic environment.

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, facilities rent, occupancy costs, depreciation and amortization and supply costs.

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Our Laboratory gross margin increased slightly to 46.7% for the three months ended March 31, 2010 as compared to 46.3% in the prior year's comparable period. The gross margin remained comparable to the prior year period as increases in transportation costs were more than offset by decreases in direct labor costs and laboratory supplies.

**Medical Technology Segment**

The following table summarizes revenue and gross profit for our Medical Technology segment (in thousands, except percentages):

	<b>Three Months Ended March 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>% Change</b>
Revenue	\$ 15,797	\$ 8,785	79.8%
Gross profit	\$ 4,831	\$ 3,228	49.7%
Gross margin	30.6%	36.7%	

Medical Technology revenue increased \$7.0 million for the three months ended March 31, 2010 as compared to the prior year comparable period. The increase was due to increases in the unit sales of each of our digital radiography equipment product lines partially due to our ability to integrate the Eklin product line. In addition, we experienced an overall increase in revenue per unit due to a shift in product mix. Customer service revenue and ultrasound sales also increased during the quarter. Medical Technology revenue also benefited from a change in our revenue recognition policy due to the implementation of new accounting guidance. See Note 3, *Multiple-Deliverable Revenue Arrangements*.

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.

Medical Technology gross profit increased \$1.6 million for the three months ended March 31, 2010, as compared to the prior year comparable period and gross margin decreased to 30.6% from 36.7% for the three months ended March 31, 2010 and March 31, 2009, respectively. The increase in gross profit is attributable to the increase in revenue as discussed above. The decline in gross margin was due in part to a change in the product mix related to sales of certain products offered as a result of our acquisition of Eklin.

**Intercompany Revenue**

Laboratory revenue for the three months ended March 31, 2010 included intercompany revenue of \$8.8 million that was generated by providing laboratory services to our animal hospitals. Medical Technology revenue for the three months ended March 31, 2010 included intercompany revenue of \$1.1 million that was generated by providing products and 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.

**Table of Contents****Selling, General and Administrative Expense**

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

	Three Months Ended March 31,				
	2010		2009		% Change
	\$	% of Revenue	\$	% of Revenue	
Animal Hospital	\$ 5,587	2.3%	\$ 5,384	2.3%	3.8%
Laboratory	6,154	7.9%	5,567	7.1%	10.5%
Medical Technology	3,515	22.3%	2,812	32.0%	25.0%
Corporate	10,884	3.3%	9,154	2.9%	18.9%
Total SG&A	\$ 26,140	7.9%	\$ 22,917	7.2%	14.1%

Consolidated SG&A increased \$3.2 million for the three months ended March 31, 2010 primarily due to corporate SG&A which rose due to increases in legal fees and payroll related costs. Laboratory SG&A increased primarily due to higher marketing and tradeshow costs, and Medical Technology which increased related to the expansion of the overall business.

**Operating Income**

The following table summarizes our operating income in both dollars and as a percentage of applicable revenue (in thousands, except percentages):

	Three Months Ended March 31,				
	2010		2009		% Change
	\$	% of Revenue	\$	% of Revenue	
Animal Hospital	\$ 36,106	14.6%	\$ 38,039	16.0%	(5.1)%
Laboratory	30,373	38.9%	30,462	39.1%	(0.3)%
Medical Technology	1,276	8.1%	415	4.7%	207.5%
Corporate	(10,884)		(9,162)		18.8%
Intercompany	(241)		(254)		(5.1)%
Total operating income	\$ 56,630	17.1%	\$ 59,500	18.8%	(4.8)%

The decrease in our consolidated operating income during the three months ended March 31, 2010 was primarily due to the aforementioned decline in Animal Hospital gross profit.

**Table of Contents****Interest Expense, Net**

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Interest expense (income):		
Senior term notes	\$ 2,249	\$ 2,587
Interest rate hedging agreements	382	3,245
Capital leases and other	564	580
Amortization of debt costs	132	120
	3,327	6,532
Interest income	(160)	(414)
Total interest expense, net of interest income	\$ 3,167	\$ 6,118

The decrease in net interest expense for the three months ended March 31, 2010 was attributable to a decrease in the overall weighted average interest rate primarily due to the gradual expiration of all of our higher cost fixed-rate swap agreements during the last twelve months.

**Liquidity and Capital Resources****Introduction**

We generate cash primarily from payments made by customers for our veterinary services, payments from animal hospitals and other clients for our laboratory services, and from proceeds received from the sale of our imaging equipment and other related services. Our business historically has experienced strong liquidity, as fees for services provided in our animal hospitals are due at the time of service and fees for laboratory services are collected under standard industry terms. Our cash disbursements are primarily for payments related to the compensation of our employees, supplies and inventory purchases for our operating segments, occupancy and other administrative costs, interest expense, payments on long-term borrowings, capital expenditures and animal hospital acquisitions. Cash outflows fluctuate with the amount and timing of the settlement of these transactions.

We manage our cash, investments and capital structure so we are able to meet the short-term and long-term obligations of our business while maintaining financial flexibility and liquidity. We forecast, analyze and monitor our cash flows to enable investment and financing within the overall constraints of our financial strategy.

At March 31, 2010, our consolidated cash and cash equivalents totaled \$178.2 million, representing an increase of \$33.0 million as compared to December 31, 2009. Cash flows generated from operating activities totaled \$70.6 million in 2010, representing an increase of \$19.4 million as compared to the three months ended March 31, 2009.

We have historically funded our working capital requirements, capital expenditures and investment in individual acquisitions from internally generated cash flows and we expect to do so in the future. As of March 31, 2010, we have access to an unused \$75.0 million revolving credit facility; however the revolving credit facility will expire in May 2010. We do not plan to renew this facility upon expiration. Historically, we have been able to obtain cash from other additional borrowings. The availability of financing in the form of debt or equity is influenced by many factors including our profitability, operating cash flows, debt levels, debt ratings, contractual restrictions and market conditions. Although in the past we have been able to obtain financing for material transactions on terms that we believe to be reasonable, there is a possibility that we may not be able to obtain financing on favorable terms in the future.

**Table of Contents****Future Cash Flows*****Short-Term***

Other than our acquisitions of animal hospital chains, we historically have funded our working capital requirements, capital expenditures and investments in animal hospital acquisitions from internally generated cash flows. We anticipate that our cash on hand and net cash provided by operations will be sufficient to meet our anticipated cash requirements for the next 12 months. If we consummate one or more significant acquisitions of animal hospital chains during this period, we may seek additional debt or equity financing.

For the year ended December 31, 2010, we expect to spend \$50.0 million to \$60.0 million, excluding real estate, related to the acquisition of independent animal hospitals. The ultimate number of acquisitions and cash used is largely dependent upon the attractiveness of the candidates and the strategic fit within our operations. During the quarter ended March 31, 2010, we spent \$8.5 million in connection with the acquisition of four animal hospitals, as well as \$1.3 million for the related real estate. In addition, we expect to spend approximately \$65.0 million in 2010 for both property and equipment additions and capital costs necessary to maintain our existing facilities.

***Long-Term***

Our long-term liquidity needs, other than those related to the day-to-day operations of our business, including commitments for operating leases, generally are comprised of scheduled principal and interest payments for our outstanding long-term indebtedness, capital expenditures related to the expansion of our business, and acquisitions in accordance with our growth strategy. In addition to the scheduled payments on our senior-term notes, we are required to make mandatory prepayments in the event we have excess cash flow. Pursuant to the terms of our senior credit facility, mandatory prepayments are due on our senior-term notes equal to 75% of any excess cash flow at the end of 2010 and 2011. During the quarter ended March 31, 2010 we paid approximately \$8.8 million related to 2009 excess cash flows. Excess cash flow is defined as earnings before interest, taxes, depreciation and amortization, less voluntary and scheduled debt repayments, capital expenditures, interest payable in cash, taxes payable in cash and cash paid for acquisitions. These payments reduce on a pro rata basis the remaining scheduled principal payments.

We expect that our long-term cash flow from operations will not be sufficient to repay our long-term debt when it comes due in May 2011. We anticipate that we will refinance such indebtedness, amend its terms to extend the maturity dates, or issue common stock in our company. We do not plan to renew our revolver when it expires in May 2010; however, we are currently evaluating proposals to refinance our senior term debt from several different lending institutions. Our management cannot make any assurances that such refinancing, amendments, or equity offering, if necessary, will be available on attractive terms, if at all.

***Debt Related Covenants***

Our senior credit facility contains certain financial covenants pertaining to fixed-charge coverage and leverage ratios. In addition, the senior credit facility has restrictions pertaining to capital expenditures, acquisitions and the payment of cash dividends. As of March 31, 2010, we were in compliance with these covenants, including the two covenant ratios, the fixed-charge coverage ratio and the leverage ratio.

At March 31, 2010, we had a fixed-charge coverage ratio of 1.74 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 March 31, 2010, we had a leverage ratio of 1.84 to 1.00, which was in compliance with the required ratio of no more than 2.75 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****Historical Cash Flows**

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Cash provided by (used in):		
Operating activities	\$ 70,556	\$ 51,198
Investing activities	(26,651)	(28,615)
Financing activities	(10,942)	(2,457)
Effect of currency exchange rate changes on cash and cash equivalents	53	(1)
Increase in cash and cash equivalents	33,016	20,125
Cash and cash equivalents at beginning of period	145,181	88,959
Cash and cash equivalents at end of period	\$ 178,197	\$ 109,084

***Cash Flows from Operating Activities***

Net cash provided by operating activities increased \$19.4 million in the three months ended March 31, 2010 as compared to the prior year comparable period. This increase was primarily due to positive changes in working capital as compared to the comparable prior year period, in addition to decreases in cash paid for interest due to the expiration of our interest-rate swap agreements.

***Cash Flows from Investing Activities***

The table below presents the components of the changes in investing cash flows (in thousands):

	<b>Three Months Ended March 31,</b>		<b>Variance</b>
	<b>2010</b>	<b>2009</b>	
<b>Investing Cash Flows:</b>			
Acquisition of independent animal hospitals and laboratories	\$ (8,528)	\$ (13,095)	\$ 4,567 <sup>(1)</sup>
Other	(719)	(1,372)	653
Total cash used for acquisitions	(9,247)	(14,467)	5,220
Property and equipment additions	(16,049)	(12,886)	(3,163) <sup>(2)</sup>
Real estate acquired with acquisitions	(1,300)	(963)	(337) <sup>(3)</sup>
Proceeds from sale of assets	6	74	(68)
Other	(61)	(373)	312
Net cash used in investing activities	\$ (26,651)	\$ (28,615)	\$ 1,964

(1) The number of acquisitions will vary from year to year based upon the available pool of suitable candidates. A

discussion of our acquisitions is provided above in our *Executive Overview*.

- (2) The increase in cash used to acquire property and equipment was related to the maintenance and expansion of our existing animal hospitals and laboratory facilities.
  
- (3) Due to the lower return on investment realized on acquired real estate we are highly selective in our decision to acquire real estate. The increase in cash used to acquire real estate is due to an increase in the number of opportunities that met our selective criteria.

**Table of Contents****Cash Flows from Financing Activities**

The table below presents the components of the changes in financing cash flows (in thousands):

	<b>Three Months Ended</b>		<b>Variance</b>
	<b>March 31,</b>		
	<b>2010</b>	<b>2009</b>	
<b>Financing Cash Flows:</b>			
Repayment of debt	\$ (10,822)	\$ (1,946)	\$ (8,876) <sup>(1)</sup>
Distributions to noncontrolling interest partners	(989)	(888)	(101) <sup>(2)</sup>
Proceeds from stock options exercises	2,858	557	2,301 <sup>(3)</sup>
Excess tax benefits from stock options	264		264
Stock repurchases	(2,253)	(180)	(2,073) <sup>(4)</sup>
Net cash used in financing activities	\$ (10,942)	\$ (2,457)	\$ (8,485)

(1) The cash used for repayment of debt increased \$8.9 million due primarily to the payment of excess cash flows. See discussion above under *Future Cash Flows*.

(2) The distributions to noncontrolling interest partners represent cash payments to noncontrolling interest partners for their portion of the partnerships excess cash.

(3) The number of stock option exercises has increased in comparison to the prior year

related to the increase in the market price of our stock during the three months ended March 31, 2010 and the expiration of certain stock options in the near term.

- (4) The stock repurchases for the three months ended March 2010 and March 31, 2009 represent cash paid for income taxes on behalf of employees who elected to settle their tax obligations on vested stocks with a portion of the stocks that vested.

***Off-Balance-Sheet Arrangements***

Other than operating leases, as of March 31, 2010 we do not have any off-balance-sheet financing arrangements.

***Interest Rate Swap Agreements***

As of March 31, 2010, all of our interest rate swap agreements have expired.

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 March 31, 2010, we had \$506.8 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 based on the interest rate offered to our administrative agent on LIBOR plus a margin of 1.50% per annum. We pay interest on our revolving credit facility based upon Wells Fargo's prime rate plus the margin of 0.50%.

The senior-term notes mature in May 2011 and the revolving credit facility matures in May 2010. We are currently evaluating refinancing proposals from various lenders.

***Other Debt and Capital Lease Obligations***

At March 31, 2010, we had seller notes secured by assets of certain animal hospitals, unsecured debt and capital leases that totaled \$27.5 million.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

At March 31, 2010, we had borrowings of \$506.8 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. There has been no change in our assessment of the impact of changes on interest expense for fluctuation in LIBOR since the year ended December 31, 2009.

In the future, we may enter into interest rate strategies to mitigate our exposure to increasing interest rates as well as to maintain an appropriate mix of fixed-rate and variable-rate debt. However, we have not yet determined what those strategies may be or their possible impact.

**ITEM 4. CONTROLS AND PROCEDURES**

We carried out an evaluation required by the Exchange Act, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

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.

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur, or that all control issues and instances of fraud, if any, within the company have been detected.

**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**

There have been no material changes in our risk factors from those disclosed in our 2009 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 5. OTHER INFORMATION**

None

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**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.

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**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 May 7, 2010.

Date: May 7, 2010

By: /s/ Tomas W. Fuller  
Tomas W. Fuller  
Chief Financial Officer

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**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
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.