

VCA ANTECH INC
Form 10-K
February 28, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2013
or

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

95-4097995

(State or other jurisdiction of
incorporation or organization)

(I.R.S. employer
identification no.)

12401 West Olympic Boulevard,
Los Angeles, California
(Address of principal executive offices)

90064-1022
(Zip code)

Registrant's telephone number, including area code: (310) 571-6500

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Common Stock, par value \$0.001 per share

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

The aggregate market value of the voting common equity held by non-affiliates as of June 30, 2013, was approximately \$2.2 billion, computed by reference to the price of \$26.09 per share, the price at which the common equity was last sold on such date as reported on the NASDAQ Global Select Market. For purposes of this computation, it is assumed that the shares beneficially held by directors and officers of the registrant would be deemed to be stock held by affiliates. Non-affiliated common stock outstanding at June 30, 2013 was 84,962,481 shares. Total common stock outstanding at February 24, 2014 was 88,248,976 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of the definitive Proxy Statement to be delivered to stockholders in connection with the 2014 Annual Meeting of Stockholders are incorporated by reference into Items 10, 11, 12, 13 and 14 hereof.

VCA Antech, Inc. and Subsidiaries
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PART I

ITEM 1. BUSINESS

Company Overview

We are a leading national animal healthcare company operating in the United States and Canada. We provide veterinary services and diagnostic testing to support veterinary care, we sell diagnostic imaging equipment and other medical technology products and related services to the veterinary market and we provide various communication, marketing solutions and other services to the veterinary community.

Our animal hospitals offer a full range of general medical and surgical services for companion animals, as well as specialized treatments including advanced diagnostic services, internal medicine, oncology, ophthalmology, dermatology and cardiology. In addition, we provide pharmaceutical products and perform a variety of pet wellness programs including health examinations, diagnostic testing, routine vaccinations, spaying, neutering and dental care. Our network of animal hospitals is supported by more than 3,000 veterinarians and had approximately 8.3 million patient visits in 2013. Our network of veterinary diagnostic laboratories 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. Our network of veterinary diagnostic laboratories provides diagnostic testing for over 16,000 clients, which includes standard animal hospitals, large animal practices, universities and other government organizations. Our medical technology business sells digital radiography and ultrasound imaging equipment, provides education and training on the use of that equipment, and provides consulting and mobile imaging services. Our communication and marketing solutions business provides services to veterinary practices, pharmaceutical manufacturers, and the pet owning community. Our services to veterinary practices include subscriptions to our Pro Pet Portals. The Pro Pet Portal provides an online platform for the veterinarian to offer secure individualized portals for pet owners as well as practice websites that are branded to the individual veterinary clinic. We also sell appointment reminder notices that are sent to pet owners on behalf of their clinics. Our services to manufacturers predominately involve targeted marketing programs to animal hospitals whom are subscribers to our Pro Pet Portal.

Our principal executive offices are located at 12401 West Olympic Boulevard, Los Angeles, California. We can be contacted at (310) 571-6500.

Company History

Our company was formed in 1986 as a Delaware corporation and has since established a position in the animal healthcare industry through both internal growth and by acquisitions. By our twentieth anniversary in 2006, we operated a total of 379 animal hospitals, 33 laboratories, and a supplier of digital radiography and ultrasound imaging equipment. Subsequent to 2006, our company continued to grow by adding, additional laboratories, independent animal hospitals, animal hospital chains and other ancillary businesses, the following of which were noteworthy:

On June 1, 2007, we acquired Healthy Pet Corp. (“Healthy Pet”), which operated 44 animal hospitals and a small laboratory, which primarily serviced its own animal hospitals, as of the acquisition date. This acquisition allowed us to expand our animal hospital operations, particularly in Massachusetts, Connecticut, Virginia and Georgia.

On July 1, 2009, we acquired Eklin Medical Systems, Inc. (“Eklin”), a leading seller of digital radiography, ultrasound and practice management software systems in the veterinary market. We combined the operations of Eklin with our Sound Technologies, Inc (“STI”) business unit and the resulting combined company is the largest supplier of diagnostic imaging equipment and other medical technology products tailored specifically for the veterinary market.

• On July 1 2010, we acquired Pet DRx Corporation (“Pet DRx”), which operated 23 animal hospitals as of the acquisition date. This acquisition allowed us to expand our animal hospital operations in California.

- On July 11, 2011, we acquired BrightHeart Veterinary Centers (“BrightHeart”) which operated nine animal hospitals, eight of which focus on the delivery of specialty and emergency medicine. The acquisition increased our level of market recognition in areas where we had an existing market presence.

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On August 9, 2011, we acquired Vetstreet, Inc., formerly known as MediMedia Animal Health, LLC (“Vetstreet”), the nation’s largest provider of online communications, professional education and marketing solutions to the veterinary community. The acquisition of Vetstreet expanded the breadth of our product offerings to the veterinary community.

On January 31, 2012 we expanded our operations into Canada with an increased investment in Associate Veterinary Clinics (1984) Limited (“AVC”), which operated 44 hospitals in three Canadian provinces as of the acquisition date.

Industry Overview

According to American Pet Products Association, Inc.’s (“APPA”) 2013-2014 APPA National Pet Owners Survey, the United States population of companion animals is approximately 208 million, including about 179 million dogs and cats. APPA estimates that approximately \$32 billion was spent in the United States on pets in 2013 for veterinary care, supplies, medicine and boarding and grooming. The survey indicated that the ownership of pets is widespread with approximately 83 million, or 68%, of U.S. households owning at least one pet, including companion and other animals. Specifically, 57 million households owned at least one dog and 45 million households owned at least one cat.

We believe that among pet owners there is a growing awareness of pet health and wellness, including the benefits of preventive care and specialized services. As technology continues to migrate from the human healthcare sector into the practice of veterinary medicine, more sophisticated treatments, diagnostic tests and equipment are becoming available to treat companion animals. These new and increasingly complex procedures, diagnostic tests, including laboratory testing and advanced imaging, and pharmaceuticals are gaining wider acceptance as pet owners are exposed to these previously unconsidered treatment programs through their exposure with this technology in human healthcare, and through literature and marketing programs sponsored by large pharmaceutical and pet nutrition companies.

Even as treatments available in veterinary medicine become more complex, prices for veterinary services typically remain a low percentage of a pet owner’s income, facilitating payment at the time of service. Unlike the human healthcare industry, providers of veterinary services are not dependent on third-party payers in order to collect fees. As such, providers of veterinary services typically do not have the problems of extended payment collection cycles or pricing pressures from third-party payers faced by human healthcare providers. Outsourced laboratory testing and diagnostic equipment sales are wholesale businesses that collect payments directly from animal hospitals under standard industry payment terms. Fees for services provided in our animal hospitals are due at the time of service. In 2013, over 99% of our animal hospital services were paid at the time of service. In addition, over the past three fiscal years our bad debt expense has averaged less than 1% of total revenue.

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 infestation of fleas, heartworms and ticks, and the number of daylight hours.

Animal Hospital Industry

Animal healthcare is provided predominately by the veterinarian practicing as a sole practitioner, or as part of a larger group practice or hospital. Veterinarians diagnose and treat animal illnesses and injuries, perform surgeries, provide routine medical exams and prescribe medication. Some veterinarians specialize by type of medicine, such as orthopedics, dentistry, ophthalmology or dermatology. Others focus on a particular type of animal. The principal factors in a pet owner’s decision as to which veterinarian to use include convenient location and hours, personal recommendations, reasonable fees and quality of care.

According to the American Veterinary Medical Association, the U.S. market for veterinary services is highly fragmented with more than 53,000 veterinarians practicing at the end of 2013. We have estimated that there are over 26,000 companion animal hospitals operating at the end of 2013. Although most animal hospitals are single-site, sole-practitioner facilities, we believe veterinarians are gravitating toward larger, multi-doctor animal hospitals that provide state-of-the-art facilities, treatments, methods and pharmaceuticals to enhance the services they can provide their clients.

Well-capitalized animal hospital operators have the opportunity to supplement their internal growth with selective acquisitions. We believe the extremely fragmented animal hospital industry is consolidating due to:

the choice of some owners of animal hospitals to diversify their investment portfolio by selling all or a portion of their investment in the animal hospital;

- the purchasing, marketing and administrative cost advantages that can be realized by a large, multiple location, multi-doctor veterinary provider;

- the cost of financing equipment purchases and upgrading technology necessary for a successful practice;

- the desire of veterinarians to focus on practicing veterinary medicine, rather than spending large portions of their time performing the administrative tasks necessary to operate an animal hospital; and

- the appeal to many veterinarians of the benefits and flexible work schedule that is not typically available to a sole practitioner or single-site provider.

Diagnostic Laboratory Industry

Veterinarians use laboratory tests to diagnose and monitor illnesses and conditions through the detection of substances in urine, tissue, fecal and blood samples, and other specimens. As is the case with the physician treating a human patient, laboratory diagnostic testing is becoming a routine diagnostic tool used by the veterinarian.

Veterinary laboratory tests are performed primarily at veterinary diagnostic laboratories, universities or at animal hospitals using on-site diagnostic equipment. For certain tests, on-site diagnostic equipment can provide more timely results than outside laboratories, but this in-house testing requires the animal hospital or veterinarian to purchase or lease the equipment, maintain and calibrate the equipment periodically to avoid testing errors, employ trained personnel to operate it and purchase testing supplies. Conversely, veterinary diagnostic laboratories can provide a wider range of tests than generally are available on-site at most animal hospitals and do not require any up-front investment on the part of the animal hospital or veterinarian. Leading veterinary diagnostic laboratories also employ highly trained individuals who specialize in the detection and diagnosis of diseases and thus are a valuable resource for the veterinarian.

Our laboratories offer a broad spectrum of standard and customized tests to the veterinary market, convenient sample pick-up times, rapid test reporting and access to professional consulting services provided by trained specialists. Providing the customer with this level of service at competitive prices requires high throughput volumes due to the operating leverage associated with the laboratory business. As a result, larger laboratories are likely to have a competitive advantage relative to smaller laboratories.

We believe that the outsourced laboratory testing market is an integral segment of the animal healthcare industry as a result of:

- the emphasis in veterinary education on diagnostic tests and the trend toward specialization in veterinary medicine, which are causing veterinarians to increasingly rely on tests for more accurate diagnoses;

- the continued technological developments in veterinary medicine, which are increasing the breadth of tests offered; and

- the continued focus on wellness, early detection and monitoring programs in veterinary medicine.

Business Strategy

Our business strategy is to continue expanding our market leadership in animal healthcare through our Animal Hospital, Laboratory, Medical Technology and Vetstreet operating segments. Key elements to our strategy include:

Capitalizing on our Leading Market Position to Generate Revenue Growth. Our leading market position in the animal hospital, veterinary laboratory and the online communications markets positions us to capitalize on favorable growth trends in the animal healthcare industry. In our animal hospitals, we seek to generate revenue growth by capitalizing on the growing emphasis on pet health and wellness. In our laboratories, we seek to generate revenue growth by taking advantage of the growing number of outsourced diagnostic tests, the opportunities to expand the testing that we provide and by increasing our market share. We continually educate veterinarians on new and existing technologies and tests available to diagnose medical conditions. Further, we leverage the knowledge of our specialists by providing veterinarians with extensive client support in utilizing and understanding these diagnostic tests. Our Medical Technology business seeks to leverage our strengths in the broader veterinary markets by introducing technologies, products and services to the veterinary market. We seek to generate revenue growth by increasing our market share and educating veterinarians on new and existing technologies. In our Vetstreet business, we seek to generate revenue growth by providing integrated animal healthcare online and offline educational products,

communication products and customized solutions for pharmaceutical manufacturers and veterinary professionals seeking to influence pet owner behavior in a medically appropriate way. By providing pet owners the basic knowledge they need to get more attuned to their pets' health, providing them authoritative pet health information and encouraging them to create and maintain a close relationship with the veterinarian of their choice, veterinary practice revenues should benefit.

Leveraging Established Infrastructure to Improve Margins. We intend to leverage our established Animal Hospital and Laboratory infrastructure to increase our operating margins. Due to our established networks and the fixed cost nature of our business model, we are able to realize high margins on incremental revenue from Animal Hospital and Laboratory customers. For example, given that our nationwide transportation network servicing our Laboratory customers is a relatively fixed cost, we are able to achieve significantly higher margins on most incremental tests ordered by the same customer when picked up by our couriers at the same time.

Utilizing Enterprise-Wide Information Systems to Improve Operating Efficiencies. Our Laboratory and the majority of our Animal Hospital operations utilize enterprise-wide management information systems. We believe that these common systems enable us to more effectively manage the key operating metrics that drive our business. With the aid of these systems, we seek to standardize pricing, expand the services we provide and increase volume through targeted marketing programs.

Pursuing Selected Acquisitions. The fragmentation of the animal hospital industry provides us with significant expansion opportunities in our Animal Hospital segment. Depending upon the attractiveness of the candidates and the strategic fit with our existing operations, we intend to acquire independent animal hospitals each year with aggregate annual revenue of approximately \$50 million to \$85 million. Our overall acquisition strategy involves the identification of high-quality practices where we can create additional value through the services and scale we can provide. Our typical candidate mirrors the profile of our existing animal hospital base. These acquisitions will be used to both expand existing markets and to enter into new geographic areas. In addition, we also evaluate the acquisition of animal hospital chains, laboratories or related businesses if favorable opportunities are presented. We intend primarily to use cash in our acquisitions but, depending on the timing and amount of our acquisitions, we may use stock or debt.

Business Segments

We report our results of operations through two reportable segments: Animal Hospital and Laboratory. Our Vetstreet and Medical Technology operating segments do not meet the materiality requirements to be presented as separate reportable segments. Accordingly, they are grouped into an "All Other" category.

Information regarding revenue and operating income, attributable to each of our reportable segments, is included in the Segment Results section within Management's Discussion and Analysis of Financial Condition and Results of Operations, and within Note 15, Lines of Business, of our Notes to Consolidated Financial Statements, which are incorporated herein by reference.

Animal Hospital

At December 31, 2013, we operated or managed 609 animal hospitals serving 41 states and four Canadian provinces. Our Animal Hospital revenue accounted for 79%, 78% and 77% of total consolidated revenue in 2013, 2012 and 2011, respectively.

Services

In addition to general medical and surgical services, we offer specialized treatments for companion animals, including advanced diagnostic services, internal medicine, oncology, neurology, endocrinology, ophthalmology, dermatology and cardiology. We also provide pharmaceutical products for use in the delivery of treatments by our veterinarians and pet owners. Many of our animal hospitals offer additional services, including grooming, bathing and boarding. We also sell specialty pet products at our animal hospitals, including pet food, vitamins, therapeutic shampoos and conditioners, flea collars and sprays, and other accessory products.

Animal Hospital Network

We seek to provide quality care in clean, attractive facilities that are generally open between 10 to 15 hours per day, six to seven days per week. Our typical animal hospital:

is located in a 4,000 to 6,000 square-foot, freestanding facility in an attractive location;

has annual revenue between \$1 million and \$3 million;

is supported by three to five veterinarians; and

has an operating history of over 10 years.

As of December 31, 2013, our network of freestanding, full-service animal hospitals had facilities located in the following states and four Canadian provinces:

California	108	Nevada	7
Texas*	48	Hawaii	6
Washington*	33	Minnesota*	6
New York*	30	Alaska	5
Florida	29	New Mexico	5
Massachusetts	27	Delaware	4
Pennsylvania	26	New Hampshire*	4
Illinois	19	South Carolina	4
Virginia	18	Wisconsin	4
Georgia	18	Missouri	3
Colorado	18	Rhode Island*	3
Connecticut	15	Tennessee	3
Arizona	14	Kansas*	