

VCA ANTECH INC  
Form 10-Q  
August 09, 2007

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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 June 30, 2007**

**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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 83,830,485 shares as of August 6, 2007.

**VCA ANTECH, INC.**  
**FORM 10-Q**  
**JUNE 30, 2007**  
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CONDENSED, CONSOLIDATED BALANCE SHEETS**

As of June 30, 2007 and December 31, 2006

(Unaudited)

(In thousands, except par value)

|  | June 30,<br>2007    | December<br>31,<br>2006 |
|--|---------------------|-------------------------|
| <b>ASSETS</b>  |                     |                         |
| Current assets:  |                     |                         |
| Cash and cash equivalents  | \$ 62,107           | \$ 45,104               |
| Trade accounts receivable, less allowance for uncollectible accounts of \$11,131 and \$11,195 at June 30, 2007 and December 31, 2006, respectively     | 48,071              | 44,491                  |
| Inventory  | 20,832              | 21,420                  |
| Prepaid expenses and other   | 15,617              | 13,492                  |
| Deferred income taxes  | 16,988              | 14,935                  |
| Prepaid income taxes   | 579                 | 13,523                  |
| <b>Total current assets</b>  | <b>164,194</b>      | <b>152,965</b>          |
| Property and equipment, less accumulated depreciation and amortization of \$121,212 and \$111,165 at June 30, 2007 and December 31, 2006, respectively | 192,081             | 166,033                 |
| Other assets:  |                     |                         |
| Goodwill   | 833,336             | 625,748                 |
| Other intangible assets, net   | 17,756              | 16,293                  |
| Deferred financing costs, net  | 1,636               | 979                     |
| Other  | 12,003              | 9,939                   |
| <b>Total assets</b>  | <b>\$ 1,221,006</b> | <b>\$ 971,957</b>       |

**LIABILITIES AND STOCKHOLDERS EQUITY**

|  |                |               |
|--|----------------|---------------|
| Current liabilities:   |                |               |
| Current portion of long-term obligations                                       | \$ 7,554       | \$ 6,648      |
| Accounts payable   | 25,307         | 23,328        |
| Accrued payroll and related liabilities  | 36,873         | 33,864        |
| Other accrued liabilities  | 41,838         | 30,961        |
| <b>Total current liabilities</b>   | <b>111,572</b> | <b>94,801</b> |
| Long-term obligations, less current portion                                    | 540,658        | 384,067       |
| Deferred income taxes  | 44,652         | 39,804        |
| Other liabilities  | 11,855         | 13,294        |
| Minority interest  | 10,348         | 9,686         |
| Commitments and contingencies  |                |               |
| Preferred stock, par value \$0.001, 11,000 shares authorized, none outstanding |                |               |
| Stockholders equity:   |                |               |

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|  |              |            |
|--|--------------|------------|
| Common stock, par value \$0.001, 175,000 shares authorized, 83,821 and 83,560 shares outstanding as of June 30, 2007 and December 31, 2006, respectively | 84           | 84         |
| Additional paid-in capital   | 282,521      | 275,013    |
| Retained earnings  | 218,746      | 154,586    |
| Accumulated other comprehensive income   | 570          | 622        |
| Total stockholders' equity   | 501,921      | 430,305    |
| Total liabilities and stockholders' equity   | \$ 1,221,006 | \$ 971,957 |

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

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**VCA ANTECH, INC. AND SUBSIDIARIES**  
**CONDENSED, CONSOLIDATED INCOME STATEMENTS**  
**For the Three and Six Months Ended June 30, 2007 and 2006**  
**(Unaudited)**  
**(In thousands, except per share amounts)**

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
| Revenue  | \$ 300,305                | \$ 255,150  | \$ 565,450              | \$ 489,330  |
| Direct costs   | 210,427                   | 180,188     | 399,652                 | 350,847     |
| Gross profit   | 89,878                    | 74,962      | 165,798                 | 138,483     |
| Selling, general and administrative expense                    | 22,043                    | 19,484      | 43,516                  | 38,369      |
| Write-down and loss (gain) sale of assets                      | 420                       | (85)        | 542                     | (203)       |
| Operating income   | 67,415                    | 55,563      | 121,740                 | 100,317     |
| Interest expense, net  | 6,671                     | 5,927       | 12,444                  | 12,239      |
| Other (income) expense   | 172                       | (31)        | 227                     | (97)        |
| Income before minority interest and provision for income taxes | 60,572                    | 49,667      | 109,069                 | 88,175      |
| Minority interest in income of subsidiaries                    | 1,028                     | 900         | 1,874                   | 1,674       |
| Income before provision for income taxes                       | 59,544                    | 48,767      | 107,195                 | 86,501      |
| Provision for income taxes                                     | 23,697                    | 19,214      | 43,035                  | 27,289      |
| Net income   | \$ 35,847                 | \$ 29,553   | \$ 64,160               | \$ 59,212   |
| Basic earnings per common share                                | \$ 0.43                   | \$ 0.36     | \$ 0.77                 | \$ 0.71     |
| Diluted earnings per common share                              | \$ 0.42                   | \$ 0.35     | \$ 0.75                 | \$ 0.70     |
| Shares used for computing basic earnings per share             | 83,742                    | 83,118      | 83,674                  | 82,966      |
| Shares used for computing diluted earnings per share           | 85,605                    | 84,838      | 85,481                  | 84,699      |

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

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**VCA ANTECH, INC. AND SUBSIDIARIES**  
**CONDENSED, CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Six Months Ended June 30, 2007 and 2006**  
**(Unaudited)**  
**(In thousands)**

|   | <b>Six Months Ended</b> |             |
|---|-------------------------|-------------|
|   | <b>June 30,</b>         |             |
|   | <b>2007</b>             | <b>2006</b> |
| Cash flows from operating activities:   |                         |             |
| Net income  | \$ 64,160               | \$ 59,212   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |             |
| Depreciation and amortization   | 12,740                  | 10,851      |
| Amortization of debt issue costs  | 137                     | 226         |
| Provision for uncollectible accounts  | 2,110                   | 2,976       |
| Write-down and loss (gain) on sale of assets                                      | 542                     | (203)       |
| Share-based compensation  | 2,300                   | 1,445       |
| Excess tax benefit from exercise of stock options                                 | (2,680)                 | (3,939)     |
| Minority interest in income of subsidiaries                                       | 1,874                   | 1,674       |
| Distributions to minority interest partners                                       | (1,364)                 | (1,339)     |
| Deferred income taxes   | 3,025                   | 4,701       |
| Other   | (173)                   | (561)       |
| Changes in operating assets and liabilities:                                      |                         |             |
| Accounts receivable   | (5,244)                 | (6,182)     |
| Inventory, prepaid expenses and other assets                                      | 45                      | (4,555)     |
| Accounts payable and other accrued liabilities                                    | (173)                   | (6,480)     |
| Accrued payroll and related liabilities   | 1,105                   | (526)       |
| Income taxes  | 15,789                  | 6,841       |
| Net cash provided by operating activities   | 94,193                  | 64,141      |
| Cash flows from investing activities:   |                         |             |
| Business acquisitions, net of cash acquired                                       | (203,322)               | (30,172)    |
| Real estate acquired in connection with business acquisitions                     | (7,962)                 | (1,781)     |
| Property and equipment additions  | (27,236)                | (15,067)    |
| Proceeds from sale of assets  | 1,564                   | 297         |
| Other   | (256)                   | 161         |
| Net cash used in investing activities   | (237,212)               | (46,562)    |
| Cash flows from financing activities:   |                         |             |
| Repayment of long-term obligations  | (4,224)                 | (62,781)    |
| Proceeds from the issuance of long-term obligations                               | 160,000                 |             |
| Payment of debt issue costs   | (794)                   |             |
| Proceeds from issuance of common stock under stock option plans                   | 2,360                   | 3,576       |
| Excess tax benefit from exercise of stock options                                 | 2,680                   | 3,939       |
| Net cash provided by (used in) financing activities                               | 160,022                 | (55,266)    |



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|  |           |           |
|--|-----------|-----------|
| Increase (decrease) in cash and cash equivalents | 17,003    | (37,687)  |
| Cash and cash equivalents at beginning of period | 45,104    | 58,488    |
| Cash and cash equivalents at end of period       | \$ 62,107 | \$ 20,801 |

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**  
**June 30, 2007**  
**(Unaudited)**

**1. General**

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

The preparation of our condensed, consolidated financial statements in accordance with generally accepted accounting principles in the United States requires our 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.

**2. Acquisitions**

We acquired the following hospitals during the six months ended June 30, 2007:

|   |     |
|---|-----|
| Hospital acquisitions, excluding Healthy Pet (1)          | 24  |
| Healthy Pet (1)   | 44  |
| Acquisitions relocated into our existing animal hospitals | (7) |
| Total   | 61  |

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

***Animal Hospital Acquisitions, Excluding Healthy Pet***

The following table summarizes the preliminary purchase price, including acquisition costs, paid by us for the 24 animal hospitals, excluding Healthy Pet, we acquired during the six months ended June 30, 2007, and the preliminary allocation of the purchase price (in thousands):

**Preliminary Purchase Price:**

|                     |           |
|---------------------|-----------|
| Cash                | \$ 47,055 |
| Liabilities assumed | 2,147     |
| Total               | \$ 49,202 |

**Preliminary Allocation of the Purchase Price:**

|                                |          |
|--------------------------------|----------|
| Tangible assets                | \$ 2,293 |
| Identifiable intangible assets | 2,146    |
| Goodwill (1)                   | 44,763   |

Total

\$ 49,202

(1) We expect that \$43.1 million of the goodwill recorded for these acquisitions as of June 30, 2007 will be deductible for income tax purposes.

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

We acquired Healthy Pet for a preliminary purchase price of \$169.3 million. The following table summarizes the preliminary purchase price and the preliminary allocation of the purchase price (in thousands):

**Preliminary Purchase Price:**

|   |                   |
|---|-------------------|
| Cash paid to holders of Healthy Pet stock and debt, net of cash acquired                        | \$ 153,189        |
| Cash paid for professional services   | 1,187             |
| Debt and capital leases assumed   | 1,721             |
| Liabilities assumed   | 10,262            |
| Liabilities for our plan to eliminate duplicate functions and to close certain animal hospitals | 2,952             |
| <b>Total</b>  | <b>\$ 169,311</b> |

**Preliminary Allocation of the Purchase Price:**

|                                |                   |
|--------------------------------|-------------------|
| Tangible assets                | \$ 3,204          |
| Identifiable intangible assets | 1,348             |
| Goodwill (1)                   | 164,759           |
| <b>Total</b>                   | <b>\$ 169,311</b> |

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

The purchase price and the allocation of the purchase price is preliminary because certain events have not occurred or have not been completed or finalized, including but not limited to, the valuation of assets, including intangible assets, and liabilities, our plan to eliminate duplicate functions and close certain animal hospitals, the finalization of the purchase price, which is subject to normal terms and conditions, including working capital adjustments, and the final billings for professional services used in the acquisition.

***Other Acquisition Payments***

In connection with certain acquisitions, we withheld a portion of the purchase price ( holdback ) as security for indemnification obligations of the sellers under the acquisition agreement. We paid \$1.1 million to sellers for the unused portion of holdbacks during the six months ended June 30, 2007.

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

**3. Long-Term Obligations and Interest Rate Swap Agreements**

On June 1, 2007, we amended our senior credit facility to allow for additional senior term notes in the amount of \$160.0 million. The funds borrowed from the additional senior term notes were primarily used to fund the acquisition of Healthy Pet on June 1, 2007. The terms, including the interest rate, of these additional senior term notes are the same as the senior term notes existing prior to the amendment. Principal payments on the additional senior term notes are due quarterly in the amount of \$400,000 and a final payment in the amount of \$153.6 million is due on May 16, 2011. In connection with this amendment, we incurred debt issue costs in the amount of \$794,000.

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During the six months ended June 30, 2007, we entered into the following interest rate swap agreements to mitigate our exposure to the possibility of interest rates increasing:

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

**4. Goodwill and Other Intangible Assets**

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

|   | <b>Laboratory</b> | <b>Animal<br/>Hospital</b> | <b>Medical<br/>Equipment</b> | <b>Total</b> |
|---|-------------------|----------------------------|------------------------------|--------------|
| Balance as of December 31, 2006           | \$ 95,310         | \$ 511,278                 | \$ 19,160                    | \$ 625,748   |
| Goodwill acquired                         |                   | 209,928                    |                              | 209,928      |
| Goodwill related to partnership interests |                   | 345                        |                              | 345          |
| Other (1)                                 |                   | (2,685)                    |                              | (2,685)      |
| Balance as of June 30, 2007               | \$ 95,310         | \$ 718,866                 | \$ 19,160                    | \$ 833,336   |

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

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

|  | <b>As of June 30, 2007</b>           |                                     |                                    | <b>As of December 31, 2006</b>       |                                     |                                    |
|--|--------------------------------------|-------------------------------------|------------------------------------|--------------------------------------|-------------------------------------|------------------------------------|
|  | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Net<br/>Carrying<br/>Amount</b> | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Net<br/>Carrying<br/>Amount</b> |
| Covenants not-to-compete               | \$ 14,801                            | \$ (6,476)                          | \$ 8,325                           | \$ 12,687                            | \$ (6,169)                          | \$ 6,518                           |
| Non-contractual customer relationships | 9,869                                | (1,984)                             | 7,885                              | 9,869                                | (1,553)                             | 8,316                              |
| Technology                             | 1,270                                | (695)                               | 575                                | 1,270                                | (568)                               | 702                                |
| Trademarks                             | 582                                  | (156)                               | 426                                | 569                                  | (127)                               | 442                                |
| Contracts                              | 380                                  | (261)                               | 119                                | 397                                  | (231)                               | 166                                |
| Client lists                           | 471                                  | (45)                                | 426                                | 506                                  | (357)                               | 149                                |

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Total                           \$ 27,373     \$   (9,617)     \$ 17,756     \$ 25,298     \$   (9,005)     \$ 16,293

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

|                                | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|                                | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
| Aggregate amortization expense | \$ 1,065                  | \$ 868      | \$ 2,030                | \$ 1,728    |

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

|                   |                  |
|-------------------|------------------|
| Remainder of 2007 | \$ 2,193         |
| 2008              | 3,924            |
| 2009              | 2,771            |
| 2010              | 1,749            |
| 2011              | 1,143            |
| Thereafter        | 5,976            |
| <b>Total</b>      | <b>\$ 17,756</b> |

**5. Share-Based Compensation**

During the six months ended June 30, 2007, we granted 351,432 nonvested shares with a weighted-average grant date fair value of \$32.75 per share. At June 30, 2007, there was \$9.7 million of unrecognized compensation cost related to these nonvested shares that will be recognized over a weighted-average period of 3.5 years. In addition to the unrecognized compensation cost related to our nonvested shares, at June 30, 2007, there was \$2.3 million of unrecognized compensation cost related to stock options granted prior to January 1, 2007, that will be recognized over a weighted-average period of 1.3 years.

**6. Income Taxes**

The effective tax rate for the six months ended June 30, 2006 includes a tax benefit in the amount of \$6.8 million recognized during the first quarter of 2006 due to the outcome of an income tax audit that resulted in a reduction to our estimated tax liabilities.

**7. Calculation of Earnings per Common Share**

Basic earnings per common share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per common 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 common share were calculated as follows (in thousands, except per share amounts):

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
| Net income                                  | \$ 35,847                 | \$ 29,553   | \$ 64,160               | \$ 59,212   |
| Weighted-average common shares outstanding: |                           |             |                         |             |
| Basic                                       | 83,742                    | 83,118      | 83,674                  | 82,966      |
| Effect of dilutive potential common shares: |                           |             |                         |             |
| Stock options and nonvested shares          | 1,863                     | 1,720       | 1,807                   | 1,733       |
| Diluted                                     | 85,605                    | 84,838      | 85,481                  | 84,699      |
| Basic earnings per common share             | \$ 0.43                   | \$ 0.36     | \$ 0.77                 | \$ 0.71     |
| Diluted earnings per common share           | \$ 0.42                   | \$ 0.35     | \$ 0.75                 | \$ 0.70     |

**8. Segment Reporting**



We have four reportable segments: laboratory, animal hospital, medical technology and corporate. 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. The laboratory segment provides diagnostic laboratory testing services for veterinarians, both associated with our animal hospitals and those independent of us. The animal hospital segment provides veterinary services for

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companion animals and sells related retail and pharmaceutical products. The medical technology segment sells digital radiography and ultrasound imaging equipment, related computer hardware, software and ancillary services to the veterinary market. The corporate segment provides general and administrative support services for the other segments.

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

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

|  | <b>Laboratory</b> | <b>Animal<br/>Hospital</b> | <b>Medical<br/>Technology</b> | <b>Corporate</b> | <b>Intercompany<br/>Eliminations</b> | <b>Total</b> |
|--|-------------------|----------------------------|-------------------------------|------------------|--------------------------------------|--------------|
| <b>Three Months Ended<br/>June 30, 2007</b>    |                   |                            |                               |                  |                                      |              |
| External revenue                               | \$ 72,027         | \$ 218,466                 | \$ 9,812                      | \$               | \$                                   | \$ 300,305   |
| Intersegment revenue                           | 7,183             |                            | 823                           |                  | (8,006)                              |              |
| Total revenue                                  | 79,210            | 218,466                    | 10,635                        |                  | (8,006)                              | 300,305      |
| Direct costs                                   | 39,244            | 172,165                    | 6,850                         |                  | (7,832)                              | 210,427      |
| Gross profit                                   | 39,966            | 46,301                     | 3,785                         |                  | (174)                                | 89,878       |
| Selling, general and<br>administrative expense | 5,046             | 5,321                      | 2,693                         | 8,983            |                                      | 22,043       |
| Write-down and loss on<br>sale of assets       | 58                | 322                        | 40                            |                  |                                      | 420          |
| Operating income (loss)                        | \$ 34,862         | \$ 40,658                  | \$ 1,052                      | \$ (8,983)       | \$ (174)                             | \$ 67,415    |
| Depreciation and<br>amortization               | \$ 1,593          | \$ 4,420                   | \$ 428                        | \$ 460           | \$ (92)                              | \$ 6,809     |
| Capital expenditures                           | \$ 4,601          | \$ 9,324                   | \$ 176                        | \$ 1,526         | \$ (266)                             | \$ 15,361    |
| <b>Three Months Ended<br/>June 30, 2006</b>    |                   |                            |                               |                  |                                      |              |
| External revenue                               | \$ 61,577         | \$ 186,002                 | \$ 7,571                      | \$               | \$                                   | \$ 255,150   |
| Intersegment revenue                           | 5,896             |                            | 829                           |                  | (6,725)                              |              |
| Total revenue                                  | 67,473            | 186,002                    | 8,400                         |                  | (6,725)                              | 255,150      |
| Direct costs                                   | 34,949            | 146,351                    | 5,256                         |                  | (6,368)                              | 180,188      |
| Gross profit                                   | 32,524            | 39,651                     | 3,144                         |                  | (357)                                | 74,962       |
| Selling, general and<br>administrative expense | 4,349             | 5,123                      | 2,549                         | 7,463            |                                      | 19,484       |
| Gain on sale of assets                         | (2)               | (83)                       |                               |                  |                                      | (85)         |
| Operating income (loss)                        | \$ 28,177         | \$ 34,611                  | \$ 595                        | \$ (7,463)       | \$ (357)                             | \$ 55,563    |
| Depreciation and<br>amortization               | \$ 1,080          | \$ 3,569                   | \$ 373                        | \$ 444           | \$ (37)                              | \$ 5,429     |
| Capital expenditures                           | \$ 2,194          | \$ 4,647                   | \$ 38                         | \$ 500           | \$ (172)                             | \$ 7,207     |

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|  | <b>Laboratory</b> | <b>Animal<br/>Hospital</b> | <b>Medical<br/>Technology</b> | <b>Corporate</b> | <b>Intercompany<br/>Eliminations</b> | <b>Total</b> |
|--|-------------------|----------------------------|-------------------------------|------------------|--------------------------------------|--------------|
| <b>Six Months Ended<br/>June 30, 2007</b>      |                   |                            |                               |                  |                                      |              |
| External revenue                               | \$ 139,269        | \$ 405,637                 | \$ 20,544                     | \$               | \$                                   | \$ 565,450   |
| Intersegment revenue                           | 13,538            |                            | 1,263                         |                  | (14,801)                             |              |
| Total revenue                                  | 152,807           | 405,637                    | 21,807                        |                  | (14,801)                             | 565,450      |
| Direct costs                                   | 76,839            | 323,756                    | 13,711                        |                  | (14,654)                             | 399,652      |
| Gross profit                                   | 75,968            | 81,881                     | 8,096                         |                  | (147)                                | 165,798      |
| Selling, general and<br>administrative expense | 10,013            | 10,881                     | 5,628                         | 16,994           |                                      | 43,516       |
| Write-down and loss on<br>sale of assets       | 58                | 444                        | 40                            |                  |                                      | 542          |
| Operating income (loss)                        | \$ 65,897         | \$ 70,556                  | \$ 2,428                      | \$ (16,994)      | \$ (147)                             | \$ 121,740   |
| Depreciation and<br>amortization               | \$ 2,946          | \$ 8,290                   | \$ 807                        | \$ 878           | \$ (181)                             | \$ 12,740    |
| Capital expenditures                           | \$ 7,724          | \$ 16,280                  | \$ 424                        | \$ 3,136         | \$ (328)                             | \$ 27,236    |
| <b>Six Months Ended<br/>June 30, 2006</b>      |                   |                            |                               |                  |                                      |              |
| External revenue                               | \$ 117,703        | \$ 356,525                 | \$ 15,102                     | \$               | \$                                   | \$ 489,330   |
| Intersegment revenue                           | 11,307            |                            | 1,290                         |                  | (12,597)                             |              |
| Total revenue                                  | 129,010           | 356,525                    | 16,392                        |                  | (12,597)                             | 489,330      |
| Direct costs                                   | 67,936            | 284,277                    | 10,746                        |                  | (12,112)                             | 350,847      |
| Gross profit                                   | 61,074            | 72,248                     | 5,646                         |                  | (485)                                | 138,483      |
| Selling, general and<br>administrative expense | 8,443             | 9,946                      | 5,200                         | 14,780           |                                      | 38,369       |
| Loss (gain) on sale of<br>assets               | 8                 | (211)                      |                               |                  |                                      | (203)        |
| Operating income (loss)                        | \$ 52,623         | \$ 62,513                  | \$ 446                        | \$ (14,780)      | \$ (485)                             | \$ 100,317   |
| Depreciation and<br>amortization               | \$ 2,152          | \$ 7,097                   | \$ 774                        | \$ 896           | \$ (68)                              | \$ 10,851    |
| Capital expenditures                           | \$ 2,964          | \$ 11,377                  | \$ 85                         | \$ 940           | \$ (299)                             | \$ 15,067    |
| <b>At June 30, 2007</b>                        |                   |                            |                               |                  |                                      |              |
| Total assets                                   | \$ 182,718        | \$ 905,655                 | \$ 47,629                     | \$ 92,160        | \$ (7,156)                           | \$ 1,221,006 |

**At December 31, 2006**

|              |            |            |           |           |            |            |
|--------------|------------|------------|-----------|-----------|------------|------------|
| Total assets | \$ 167,363 | \$ 671,975 | \$ 53,161 | \$ 85,533 | \$ (6,075) | \$ 971,957 |
|--------------|------------|------------|-----------|-----------|------------|------------|

**9. Commitments and Contingencies**

We have certain commitments, including operating leases and supply purchase agreements. These items are discussed in detail in our consolidated financial statements and notes thereto included in our 2006 annual report on Form 10-K. We also have contingencies, which are discussed below.

*a. Earn-out Payments*

We have contractual arrangements in connection with certain acquisitions, whereby additional cash may be paid to former owners of acquired companies upon attainment of specified financial criteria as set forth in the respective agreements. The amount to be paid cannot be determined until the earn-out periods expire and the attainment of criteria is established. If the specified financial criteria are attained, we will be obligated to pay an additional \$813,000.

**Table of Contents***b. Officers Compensation*

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

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

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

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

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

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

*c. Other Contingencies*

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

**10. Recent Accounting Pronouncements**

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

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

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



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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 August 7, 2007, and we undertake no duty to update this information. Shareholders and prospective investors can find information filed with the SEC after August 7, 2007 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 services company that provides veterinary services and diagnostic testing to support veterinary care and sells diagnostic imaging equipment, other medical technology products and related services to veterinarians. Our four reportable segments are as follows:

Our laboratory segment operates the largest network of veterinary diagnostic laboratories in the nation. Our laboratories provide sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. At June 30, 2007, our laboratory network consisted of 33 laboratories serving all 50 states.

Our animal hospital segment operates the largest network of freestanding, full-service animal hospitals in the nation. Our animal hospitals offer a full range of general medical and surgical services for companion animals. We treat diseases and injuries, offer pharmaceutical and retail products and perform a variety of pet wellness programs, including health examinations, diagnostic testing, routine vaccinations, spaying, neutering and dental care. At June 30, 2007, our animal hospital network consisted of 437 animal hospitals in 38 states.

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

Our corporate segment provides general and administrative support for our other segments.

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

**Executive Overview**

The three and six months ended June 30, 2007 was marked by continued growth in our laboratory and animal hospital operating segments achieved through a combination of internal growth and acquisitions, including the acquisition of Healthy Pet Corp. ( Healthy Pet ) on June 1, 2007. For the three and six months ended June 30, 2007, our laboratory internal revenue growth was 15.9% and 16.6%, respectively, and our animal hospital same-store revenue growth was 6.6% and 6.1%, respectively. Our medical technology segment also experienced growth through the sale of its digital radiography and ultrasound imaging equipment.

**Table of Contents***Acquisitions and Facilities*

Our growth strategy includes the acquisition of independent animal hospitals. We currently anticipate that animal hospital acquired revenue for 2007 (exclusive of our acquisition of Healthy Pet discussed below) will range from \$55.0 million to \$65.0 million. In addition, we also evaluate the acquisition of animal hospital chains, laboratories or related businesses if favorable opportunities are presented. In accordance with that strategy, on June 1, 2007, we acquired Healthy Pet, which operated 44 animal hospitals and a small laboratory that primarily serviced its own animal hospitals. The acquisition of Healthy Pet provided us with the opportunity to expand our animal hospital operations on the East Coast, particularly in Massachusetts, Connecticut, Virginia and Georgia. The following table summarizes the changes in the number of facilities operated by our laboratory and animal hospital segments during the six months ended June 30, 2007:

**Laboratories:**

|   |     |
|---|-----|
| Beginning of period                                   | 33  |
| Acquisitions  | 1   |
| Acquisitions relocated into our existing laboratories | (1) |
| End of period   | 33  |

**Animal hospitals:**

|   |     |
|---|-----|
| Beginning of period                                       | 379 |
| Acquisitions, excluding Healthy Pet                       | 24  |
| Healthy Pet   | 44  |
| Acquisitions relocated into our existing animal hospitals | (7) |
| Closed  | (3) |
| End of period   | 437 |

*Financing Transaction*

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

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

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

|  | Three Months Ended<br>June 30, |       | Six Months Ended<br>June 30, |       |
|--|--------------------------------|-------|------------------------------|-------|
|  | 2007                           | 2006  | 2007                         | 2006  |
| Revenue:   |                                |       |                              |       |
| Laboratory   | 26.4%                          | 26.4% | 27.0%                        | 26.4% |
| Animal hospital  | 72.7                           | 72.9  | 71.7                         | 72.9  |
| Medical technology   | 3.5                            | 3.3   | 3.9                          | 3.3   |
| Intercompany   | (2.6)                          | (2.6) | (2.6)                        | (2.6) |
| Total revenue  | 100.0                          | 100.0 | 100.0                        | 100.0 |
| Direct costs   | 70.1                           | 70.6  | 70.7                         | 71.7  |
| Gross profit   | 29.9                           | 29.4  | 29.3                         | 28.3  |
| Selling, general and administrative expense                    | 7.3                            | 7.6   | 7.7                          | 7.8   |
| Write-down and loss on sale of assets                          | 0.2                            |       | 0.1                          |       |
| Operating income   | 22.4                           | 21.8  | 21.5                         | 20.5  |
| Interest expense, net  | 2.2                            | 2.3   | 2.3                          | 2.5   |
| Other expense  | 0.1                            |       |                              |       |
| Income before minority interest and provision for income taxes | 20.1                           | 19.5  | 19.2                         | 18.0  |
| Minority interest in income of subsidiaries                    | 0.3                            | 0.4   | 0.3                          | 0.3   |
| Income before provision for income taxes                       | 19.8                           | 19.1  | 18.9                         | 17.7  |
| Provision for income taxes                                     | 7.9                            | 7.5   | 7.6                          | 5.6   |
| Net income   | 11.9%                          | 11.6% | 11.3%                        | 12.1% |

**Revenue**

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

|                    | Three Months Ended June 30, |            |            |            |          | Six Months Ended June 30, |            |            |            |          |
|--------------------|-----------------------------|------------|------------|------------|----------|---------------------------|------------|------------|------------|----------|
|                    | 2007                        |            | 2006       |            | % Change | 2007                      |            | 2006       |            | % Change |
|                    | \$                          | % of Total | \$         | % of Total |          | \$                        | % of Total | \$         | % of Total |          |
| Laboratory         | \$ 79,210                   | 26.4%      | \$ 67,473  | 26.4%      | 17.4%    | \$ 152,807                | 27.0%      | \$ 129,010 | 26.4%      | 18.4%    |
| Animal hospital    | 218,466                     | 72.7%      | 186,002    | 72.9%      | 17.5%    | 405,637                   | 71.7%      | 356,525    | 72.9%      | 13.8%    |
| Medical technology | 10,635                      | 3.5%       | 8,400      | 3.3%       | 26.6%    | 21,807                    | 3.9%       | 16,392     | 3.3%       | 33.0%    |
| Intercompany       | (8,006)                     | (2.6)%     | (6,725)    | (2.6)%     | 19.0%    | (14,801)                  | (2.6)%     | (12,597)   | (2.6)%     | 17.5%    |
| Total revenue      | \$ 300,305                  | 100.0%     | \$ 255,150 | 100.0%     | 17.7%    | \$ 565,450                | 100.0%     | \$ 489,330 | 100.0%     | 15.6%    |



**Table of Contents***Laboratory Revenue*

Laboratory revenue increased \$11.7 million for the three months ended June 30, 2007 and increased \$23.8 million for the six months ended June 30, 2007 as compared to the same periods in the prior year. The components of the increase in laboratory revenue are detailed below (in thousands, except percentages and average price per requisition):

|                                     | Three Months Ended June 30, |           |             | Six Months Ended June 30, |            |             |
|-------------------------------------|-----------------------------|-----------|-------------|---------------------------|------------|-------------|
|                                     | 2007                        | 2006      | %<br>Change | 2007                      | 2006       | %<br>Change |
| <b>Laboratory Revenue:</b>          |                             |           |             |                           |            |             |
| Internal growth:                    |                             |           |             |                           |            |             |
| Number of requisitions (1)          | 3,441                       | 3,000     | 14.7%       | 6,511                     | 5,624      | 15.8%       |
| Average revenue per requisition (2) | \$ 22.72                    | \$ 22.49  | 1.0%        | \$ 23.10                  | \$ 22.94   | 0.7%        |
| Total internal revenue (1)          | \$ 78,186                   | \$ 67,473 | 15.9%       | \$ 150,403                | \$ 129,010 | 16.6%       |
| Acquired revenue (3)                | 1,024                       |           |             | 2,404                     |            |             |
| Total                               | \$ 79,210                   | \$ 67,473 | 17.4%       | \$ 152,807                | \$ 129,010 | 18.4%       |

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

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

requisitions.

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

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

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

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

**Table of Contents***Animal Hospital Revenue*

Animal hospital revenue increased \$32.5 million for the three months ended June 30, 2007 and increased \$49.1 million for the six months ended June 30, 2007 as compared to the same periods in the prior year. The components of the increase are summarized in the following table (in thousands, except percentages and average price per order):

|                                 | Three Months Ended June 30, |            |             | Six Months Ended June 30, |            |             |
|---------------------------------|-----------------------------|------------|-------------|---------------------------|------------|-------------|
|                                 | 2007                        | 2006       | %<br>Change | 2007                      | 2006       | %<br>Change |
| <b>Animal Hospital Revenue:</b> |                             |            |             |                           |            |             |
| Same-store facilities:          |                             |            |             |                           |            |             |
| Orders (1)(2)                   | 1,381                       | 1,375      | 0.5%        | 2,598                     | 2,589      | 0.3%        |
| Average revenue per order (3)   | \$ 141.75                   | \$ 133.61  | 6.1%        | \$ 141.25                 | \$ 133.57  | 5.7%        |
| Same-store revenue (1)          | \$ 195,827                  | \$ 183,712 | 6.6%        | \$ 366,949                | \$ 345,869 | 6.1%        |
| Net acquired revenue (4)        | 22,639                      | 2,290      |             | 38,688                    | 10,656     |             |
| Total                           | \$ 218,466                  | \$ 186,002 | 17.5%       | \$ 405,637                | \$ 356,525 | 13.8%       |

(1) Same-store revenue and orders were calculated using animal hospital operating results, adjusted to exclude the operating results for newly acquired animal hospitals that we did not own as of the beginning of the comparable period in the prior year and adjusted for the impact resulting from any differences in the number of business days in the comparable periods.  
Same-store

revenue also includes revenue generated by customers referred from our relocated or combined animal hospitals, including those merged upon acquisition.

- (2) The change in orders may not calculate exactly due to rounding.
- (3) Computed by dividing same-store revenue by same-store orders. The average revenue per order may not calculate exactly due to rounding.
- (4) 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 April 1, 2006 for the three-month analysis, and January 1, 2006



for the six-month analysis. Fluctuations in net acquired revenue occur due to the volume, size and timing of acquisitions and dispositions during the periods from this date through the end of the applicable period.

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

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

#### *Medical Technology Revenue*

Medical technology revenue increased \$2.2 million for the three months ended June 30, 2007 and increased \$5.4 million for the six months ended June 30, 2007 as compared to the comparable periods in the prior year. This increase was primarily attributable to revenue recognized for current and historical sales of our digital radiography and ultrasound imaging equipment. We recognize revenue on deferred sales ratably over a period ranging from one to five years. These deferred transactions are further discussed below in *Critical Accounting Policies*. At June 30, 2007, we had deferred revenue of \$10.5 million.

#### *Intercompany Revenue*

Laboratory revenue for the three and six months ended June 30, 2007 included intercompany revenue of \$7.2 million and \$13.5 million, respectively, that was generated by providing laboratory services to our animal hospitals. Medical technology revenue for the three and six months ended June 30, 2007 included intercompany revenue of

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\$823,000 and \$1.3 million, respectively, 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.

**Gross Profit**

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

|                    | Three Months Ended June 30, |        |           |        |        | Six Months Ended June 30, |        |            |        |        |
|--------------------|-----------------------------|--------|-----------|--------|--------|---------------------------|--------|------------|--------|--------|
|                    | 2007                        |        | 2006      |        | %      | 2007                      |        | 2006       |        | %      |
|                    | Gross                       |        | Gross     |        |        | Gross                     |        | Gross      |        |        |
|                    | \$                          | Margin | \$        | Margin | Change | \$                        | Margin | \$         | Margin | Change |
| Laboratory         | \$ 39,966                   | 50.5%  | \$ 32,524 | 48.2%  | 22.9%  | \$ 75,968                 | 49.7%  | \$ 61,074  | 47.3%  | 24.4%  |
| Animal hospital    | 46,301                      | 21.2%  | 39,651    | 21.3%  | 16.8%  | 81,881                    | 20.2%  | 72,248     | 20.3%  | 13.3%  |
| Medical technology | 3,785                       | 35.6%  | 3,144     | 37.4%  | 20.4%  | 8,096                     | 37.1%  | 5,646      | 34.4%  | 43.4%  |
| Intercompany       | (174)                       |        | (357)     |        |        | (147)                     |        | (485)      |        |        |
| Total gross profit | \$ 89,878                   | 29.9%  | \$ 74,962 | 29.4%  | 19.9%  | \$ 165,798                | 29.3%  | \$ 138,483 | 28.3%  | 19.7%  |

**Laboratory Gross Profit**

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

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

**Animal Hospital Gross Profit**

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

During the three and six months ended June 30, 2007, our animal hospital same-store gross margin improved as compared to the comparable periods in the prior year due to improvements in revenue and operating leverage. Our animal hospital same-store gross margin was 21.6% and 21.4% for the three months ended June 30, 2007 and 2006, respectively, and 20.5% and 20.4% for the six months ended June 30, 2007 and 2006, respectively. Due primarily to our recent animal hospital acquisitions, our animal hospital consolidated gross margin for the three and six months ended June 30, 2007 declined slightly from the comparable prior year period.

**Medical Technology Gross Profit**

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.



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During the three months ended June 30, 2007, our medical technology gross margin declined as compared to the comparable period in the prior year primarily due to an increase in material cost as a percentage of revenue related to the sale of our digital radiography imaging equipment.

During the six months ended June 30, 2007, our medical technology gross margin increased as compared to the comparable period in the prior year primarily due to inventory charges recognized in 2006 that were partially offset by an increase in material cost as a percentage of revenue related to the sale of our digital radiography imaging equipment.

We defer the revenue and related costs of certain transactions as discussed below in *Critical Accounting Policies*. For these transactions, the revenue and related costs are recognized ratably over a period ranging from one to five years. At June 30, 2007, we had deferred revenue and costs of \$10.5 million and \$4.7 million, respectively.

***Selling, General and Administrative Expense***

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

|                    | Three Months Ended June 30, |              |           | Six Months Ended June 30, |          |           |              |           |              |          |
|--------------------|-----------------------------|--------------|-----------|---------------------------|----------|-----------|--------------|-----------|--------------|----------|
|                    | 2007                        | 2006         | 2006      | 2007                      | 2006     | 2006      |              |           |              |          |
|                    | \$                          | % of Revenue | \$        | % of Revenue              | % Change | \$        | % of Revenue | \$        | % of Revenue | % Change |
| Laboratory         | \$ 5,046                    | 6.4%         | \$ 4,349  | 6.4%                      | 16.0%    | \$ 10,013 | 6.6%         | \$ 8,443  | 6.5%         | 18.6%    |
| Animal hospital    | 5,321                       | 2.4%         | 5,123     | 2.8%                      | 3.9%     | 10,881    | 2.7%         | 9,946     | 2.8%         | 9.4%     |
| Medical technology | 2,693                       | 25.3%        | 2,549     | 30.3%                     | 5.6%     | 5,628     | 25.8%        | 5,200     | 31.7%        | 8.2%     |
| Corporate          | 8,983                       | 3.0%         | 7,463     | 2.9%                      | 20.4%    | 16,994    | 3.0%         | 14,780    | 3.0%         | 15.0%    |
| Total SG&A         | \$ 22,043                   | 7.3%         | \$ 19,484 | 7.6%                      | 13.1%    | \$ 43,516 | 7.7%         | \$ 38,369 | 7.8%         | 13.4%    |

***Laboratory SG&A***

Laboratory SG&A consists primarily of salaries of sales, administrative and accounting personnel, selling, marketing and promotional expense.

The increase in laboratory SG&A was primarily attributable to an increase in commissions. Marketing costs and administrative support also contributed to the increase in laboratory SG&A.

***Animal Hospital SG&A***

Animal hospital SG&A consists primarily of salaries of field management, certain administrative and accounting personnel, recruiting and certain marketing expense.

The increase in animal hospital SG&A was primarily attributable to expanding the animal hospital administrative operations to absorb our recent acquisitions.

***Medical Technology SG&A***

Medical technology SG&A consists primarily of salaries of sales, administrative and accounting personnel, selling, marketing and promotional expense and research and development costs.

The increase in medical technology SG&A was primarily attributable to marketing costs and administrative support.

**Table of Contents***Corporate SG&A*

Corporate SG&A consists of administrative expense at our headquarters, including the salaries of corporate officers, administrative and accounting personnel, rent, accounting, finance, legal and other professional expense and occupancy costs as well as corporate depreciation.

The increase in corporate SG&A was primarily attributable to expanding the corporate operations to absorb our recent acquisitions and integration costs of \$675,000 relating to the acquisition of Healthy Pet.

***Write-down and Loss (Gain) on Sale of Assets***

During the six months ended June 30, 2007 and 2006, we wrote-down and sold certain assets, including real estate, for a net loss of \$542,000 and a gain of \$203,000, respectively.

***Interest Expense, Net***

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

|  | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2007</b>                            | <b>2006</b> | <b>2007</b>                          | <b>2006</b> |
| Interest expense:                              |  |             |                                      |             |
| Senior term notes                              | \$ 7,369                               | \$ 6,504    | \$ 13,774                            | \$ 12,918   |
| Interest rate hedging agreements               | (529)                                  | (370)       | (1,018)                              | (571)       |
| Capital leases and other                       | 349                                    | 197         | 699                                  | 609         |
| Amortization of debt costs                     | 76                                     | 94          | 137                                  | 227         |
|  | 7,265                                  | 6,425       | 13,592                               | 13,183      |
| Interest income                                | 594                                    | 498         | 1,148                                | 944         |
| Total interest expense, net of interest income | \$ 6,671                               | \$ 5,927    | \$ 12,444                            | \$ 12,239   |

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

***Provision for Income Taxes***

Our effective tax rate for the three months ended June 30, 2007 and 2006 was 39.8% and 39.4%, respectively, and our effective rate for the six months ended June 30, 2007 and 2006 was 40.1% and 31.5%, respectively. The effective tax rate for the six months ended June 30, 2006 includes a tax benefit in the amount of \$6.8 million recognized during the first quarter of 2006 due to the outcome of an income tax audit that resulted in a reduction to our estimated tax liabilities.

**Table of Contents****Liquidity and Capital Resources**

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

|  | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--------------------------------------|-------------|
|  | <b>2007</b>                          | <b>2006</b> |
| Cash provided by (used in):                      |                                      |             |
| Operating activities                             | \$ 94,193                            | \$ 64,141   |
| Investing activities                             | (237,212)                            | (46,562)    |
| Financing activities                             | 160,022                              | (55,266)    |
| Increase (decrease) in cash and cash equivalents | 17,003                               | (37,687)    |
| Cash and cash equivalents at beginning of year   | 45,104                               | 58,488      |
| Cash and cash equivalents at end of period       | \$ 62,107                            | \$ 20,801   |

***Cash Flows from Operating Activities***

Net cash provided by operating activities increased \$30.1 million in the six months ended June 30, 2007 as compared to the same period in the prior year primarily due to improved operating performance, acquisitions and changes in working capital, which was partially offset by an increase in taxes paid of \$1.7 million.

Borrowings under our senior credit facility bear interest based on a variable-rate component plus a margin of 1.50%. Significant increases in interest rates may materially impact our operating cash flows.

***Cash Flows from Investing Activities***

Our growth strategy includes the acquisition of independent animal hospitals. We currently anticipate that we will spend \$55.0 million to \$65.0 million in 2007 on the acquisition of animal hospitals (exclusive of our acquisition of Healthy Pet discussed below). For the six months ended June 30, 2007, we spent \$48.2 million related to the acquisition of independent animal hospitals. In addition, we also evaluate the acquisition of animal hospital chains, laboratories or related businesses if favorable opportunities are presented. In accordance with that strategy, we acquired Healthy Pet, which operated 44 animal hospitals and a small laboratory that primarily serviced its own animal hospitals, on June 1, 2007. In connection with the acquisition of Healthy Pet, we paid cash of \$154.4 million. We intend to primarily use cash in our acquisitions but, depending on the timing and amount of our acquisitions, we may use stock or debt.

Our investing activities include expenditures for property and equipment additions and we expect to spend approximately \$40.0 million to \$45.0 million in 2007 for such expenditures (exclusive of real estate acquired in connection with business acquisitions). For the six months ended June 30, 2007, we spent \$27.2 million on property and equipment additions. In addition, due to favorable opportunities presented, we also purchased real estate in connection with certain animal hospital acquisitions in the amount of \$8.0 million during the six months ended June 30, 2007.

***Cash Flows from Financing Activities***

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

**Table of Contents****Future Contractual Cash Requirements**

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

|                                    | <b>Total</b> | <b>2007 (1)</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>Thereafter</b> |
|------------------------------------|--------------|-----------------|-------------|-------------|-------------|-------------|-------------------|
| Long-term debt                     | \$ 533,014   | \$ 3,285        | \$ 6,106    | \$ 5,828    | \$ 5,855    | \$ 511,940  | \$                |
| Capital lease obligations          | 15,198       | 639             | 1,216       | 1,243       | 1,361       | 1,402       | 9,337             |
| Operating leases                   | 567,277      | 18,284          | 37,121      | 36,774      | 34,757      | 34,497      | 405,844           |
| Fixed cash interest expense        | 6,155        | 672             | 1,421       | 1,127       | 790         | 523         | 1,622             |
| Variable cash interest expense (2) | 132,414      | 17,902          | 33,606      | 33,344      | 34,344      | 13,218      |                   |
| Swap agreements (2)                | 376          | (651)           | 435         | 592         |             |             |                   |
| Purchase obligations               | 44,957       | 12,178          | 8,134       | 8,899       | 9,744       | 6,002       |                   |
| Other long-term liabilities (3)    | 46,637       |                 | 65          | 65          | 65          |             | 46,442            |
| Earn-out payments (4)              | 813          | 213             | 300         | 300         |             |             |                   |
|                                    | \$ 1,346,841 | \$ 52,522       | \$ 88,404   | \$ 88,172   | \$ 86,916   | \$ 567,582  | \$ 463,245        |

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

(2) We have variable-rate debt. The interest payments on our variable-rate debt are based on a variable-rate component plus a margin of 1.50%. For purposes of this computation, we have assumed that the interest rate on our variable-rate debt (including

the margin of 1.50%) will be 6.8%, 6.4%, 6.4%, 6.7%, and 6.9% for years 2007 through 2011, respectively.

These estimates are based on interest rate projections used to price our interest rate swap agreements. Our consolidated financial statements included in our 2006 annual report on Form 10-K discuss these variable-rate notes in more detail.

- (3) Includes deferred income taxes of \$44.7 million.
- (4) Represents contractual arrangements whereby additional cash may be paid to former owners of acquired businesses upon attainment of specified performance targets.

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

***Debt Related Covenants***



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

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, by fixed charges. Pro forma earnings before interest, taxes, depreciation and amortization include 12 months of operating results for businesses acquired during the period. Fixed charges are defined as cash interest expense, scheduled principal payments on debt obligations, capital expenditures, and provision for income taxes. At June 30, 2007, we had a fixed charge coverage ratio of 1.51 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 leverage ratio as that ratio which is calculated as total debt divided by pro forma earnings before interest, taxes, depreciation and amortization, as defined by the senior credit facility. At June 30, 2007, we had a leverage ratio of 2.14 to 1.00, which was in compliance with the required ratio of no more than 3.25 to 1.00.

**Table of Contents****Interest Rate Swap Agreements**

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

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

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

**Description of Indebtedness***Senior Credit Facility*

At June 30, 2007, we had \$530.4 million principal amount outstanding under our senior term notes and no borrowings outstanding under our revolving credit facility.

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

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

*Other Debt*

At June 30, 2007, we had seller notes secured by assets of certain animal hospitals, unsecured debt and capital leases that totaled \$17.8 million.

**Critical Accounting Policies**

We believe that the application of the following accounting policies, which are important to our financial position and results of operations, requires significant judgments and estimates on the part of management. For a summary of all our accounting policies, including the accounting policies discussed below, see our consolidated financial statements included in our 2006 annual report on Form 10-K.

**Revenue***Laboratory and Animal Hospital Revenue*

We recognize revenue when persuasive evidence of a sales arrangement exists, delivery of goods has occurred or services have been rendered, the sales price or fee is fixed or determinable and collectibility is reasonably assured.

*Medical Technology Revenue*

Our medical technology segment generates a majority of its revenue from the sale of digital radiography imaging equipment and ultrasound imaging equipment. We also generate revenue from: (i) licensing software; (ii) providing technical support and product updates related to our software, otherwise known as maintenance; (iii) providing professional services related to our equipment and software, including installations, on-site training,

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education services and extended warranty programs; and (iv) providing mobile imaging services. We frequently sell equipment and license our software in multiple element arrangements in which the customer may choose a combination of our products and services.

The accounting for the sale of equipment is substantially governed by the requirements of Staff Accounting Bulletin ( SAB ) No. 104, *Revenue Recognition* ( SAB No. 104 ), and the sale of software licenses and related items is governed by Statement of Position ( SOP ) No. 97-2, *Software Revenue Recognition* ( SOP No. 97-2 ), as amended. The determination of the amount of software license, maintenance and professional service revenue to be recognized in each accounting period requires us to exercise judgment and use estimates. In determining whether or not to recognize revenue, we evaluate each of these criteria:

**Evidence of an arrangement:** We consider a non-cancelable agreement signed by the customer and us to be evidence of an arrangement.

**Delivery:** We consider delivery to have occurred when the ultrasound imaging equipment is delivered. We consider delivery to have occurred when the digital radiography imaging equipment is delivered or accepted by the customer if installation is required. We consider delivery to have occurred with respect to professional services when those services are provided or on a straight-line basis over the service contract term, based on the nature of the service or the terms of the contract.

**Fixed or determinable fee:** We assess whether fees are fixed or determinable at the time of sale and recognize revenue if all other revenue recognition requirements are met. We generally consider payments that are due within six months to be fixed or determinable based upon our successful collection history. We only consider fees to be fixed or determinable if they are not subject to refund or adjustment.

**Collection is deemed probable:** We conduct a credit review for all significant transactions at the time of the arrangement to determine the credit worthiness of the customer. Collection is deemed probable if we expect that the customer will be able to pay amounts under the arrangement as payments become due. If we determine that collection is not probable, we defer the revenue and recognize the revenue upon cash collection.

Under the residual method prescribed by SOP No. 98-9, *Modification of SOP No. 97-2, Software Revenue Recognition, With Respect to Certain Transactions* ( SOP No. 98-9 ), in multiple element arrangements involving software that is more than incidental to the products and services as a whole, revenue is recognized when vendor-specific objective evidence ( VSOE ) of fair value exists for all of the undelivered elements in the arrangement (i.e., maintenance and professional services), but does not exist for one or more of the delivered elements in the arrangement (i.e., the equipment, computer hardware or the software product). VSOE of fair value is based on 1) the price we charge for those products and services when sold on a stand-alone basis independent of other products and services or 2) the contractual renewal rates for the post-contract customer support ( PCS ) services that we provide when we sell multiple products and services in a single transaction. Under the residual method, the fair value of the undelivered elements is deferred and recognized as revenue upon delivery, provided that other revenue recognition criteria are met. If evidence of the fair value of one or more undelivered elements does not exist, the revenue for the entire transaction, including revenue related to the delivered elements, is deferred and recognized, based on the facts and circumstances, either: 1) on a straight-line basis over the life of the PCS period if this is the only undelivered element, or 2) when the last undelivered element is delivered. Each transaction requires careful analysis to determine whether all of the individual elements in the transaction have been identified, that fair value exists for each element and that the transaction is accounted for correctly.

***Digital Radiography Imaging Equipment***

We sell our digital radiography imaging equipment with multiple elements, including hardware, software, licenses and/or services. We have determined that the software included in these sales arrangements is more than incidental to the products and services as a whole. As a result, we account for digital radiography imaging equipment sales under SOP No. 97-2, as amended.



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For those sales arrangements where we have determined VSOE of fair value for all undelivered elements, we recognize the residual revenue for the delivered elements 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. When we have established VSOE of fair value for the PCS, we recognize the revenue for these services on a straight-line basis over the period of support and recognize revenue for the delivered elements under the residual method. When we have not established VSOE of fair value for the PCS, we defer all revenue, including revenue for the delivered elements, recognizing it on a straight-line basis over the period of support.

***Ultrasound Imaging Equipment***

We sell our ultrasound imaging equipment on a stand-alone basis and with multiple elements, including hardware, software, licenses and/or services. We account for the sale of ultrasound imaging equipment on a stand-alone basis under the requirements of SAB No. 104, and recognize revenue upon delivery. We account for the sale of ultrasound imaging equipment with related computer hardware and software by bifurcating the transaction into separate elements. We account for the ultrasound imaging equipment under the requirements of SAB No. 104, as the software is not deemed to be essential to the functionality of the equipment, and account for the computer hardware and software under the requirements of SOP No. 97-2, as amended. For those sales of our ultrasound imaging equipment that include computer hardware and software, we recognize revenue on the ultrasound imaging equipment, computer hardware and software upon delivery, which occurs simultaneously.

***Digital Radiography And Ultrasound Imaging Equipment Sold Together***

In certain transactions, we sell our ultrasound imaging equipment and related services together with our digital radiography imaging equipment and related services. In these transactions, we allocate total invoice dollars to each element using a relative fair value basis. Each element is then accounted for pursuant to either SAB No. 104 or SOP No. 97-2, as applicable.

***Other Services***

We recognize revenue on mobile imaging, consulting and education services at the time the services have been rendered. We also generate revenue from extended service agreements related to our digital radiography imaging and ultrasound imaging equipment. These extended service agreements include technical support, product updates for software and extended warranty coverage. The revenue for these extended service agreements is recognized on a straight-line basis over the term of the agreement.

***Goodwill Impairment***

Our goodwill represents the excess of the cost of an acquired entity over the net of the fair value of identifiable assets acquired and liabilities assumed. The total amount of our goodwill at June 30, 2007 was \$833.3 million, consisting of \$95.3 million for our laboratory segment, \$718.8 million for our animal hospital segment and \$19.2 million for our medical technology segment.

Annually, or sooner if circumstances indicate impairment may exist, we test our goodwill for impairment by comparing the fair market values of our laboratory, animal hospital and medical technology reporting units to their respective net book values. At December 31, 2006, the estimated fair market value of each of our reporting units exceeded their respective net book value, resulting in a conclusion that our goodwill was fairly stated.

***Income Taxes***

We account for income taxes under Statement of Financial Accounting Standards ( SFAS ) No. 109, *Accounting for Income Taxes* ( SFAS No. 109 ). In accordance with SFAS No. 109, we record deferred tax assets and deferred tax liabilities, which represent taxes to be recovered or settled in the future. We adjust our deferred tax assets and deferred tax liabilities to reflect changes in tax rates or other statutory tax provisions. Changes in tax rates or other statutory provisions are recognized in the period the change occurs.

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We make judgments in assessing our ability to realize future benefits from our deferred tax assets, which include operating and capital loss carryforwards. As such, we have a valuation allowance to reduce our deferred tax assets for the portion we believe will not be realized.

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

**Recent Accounting Pronouncements**

In June 2006, the FASB issued FIN 48, which clarifies the accounting for uncertainty in tax positions. FIN 48 prescribes recognition thresholds and measurement attributes for the financial statement recognition of income tax positions. In the first quarter of 2007, we adopted FIN 48. We did not have any unrecognized tax benefits at June 30, 2007, and the adoption of FIN 48 did not have a material effect on our condensed, consolidated financial statements.

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

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

**Forward-Looking Statements**

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

**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

At June 30, 2007, we had borrowings of \$530.4 million under our senior credit facility with fluctuating interest rates based on market benchmarks such as LIBOR. For our variable-rate debt, changes in interest rates generally do not affect the fair market value, but do impact earnings and cash flow. To reduce the risk of increasing interest rates, we entered into \$325.0 million of interest rate swap agreements. Currently, we are engaged in the following interest rate swap agreements:

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

These interest rate swap agreements have the effect of reducing the amount of our debt exposed to variable interest rates from \$530.4 million to \$205.4 million. For the 12-month period ending June 30, 2008, for every 1.0% increase in LIBOR we will pay an additional \$2.0 million in interest expense and for every 1.0% decrease in LIBOR we will save \$2.0 million in interest expense.

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

**ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer, based on their evaluation as of the end of the period covered by this Form 10-Q, concluded that our disclosure controls and procedures are effective in timely alerting them to information we are required to include in our periodic reports filed with the SEC.

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

**PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 1A. RISK FACTORS**

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

Additional information relating to risk factors is described in *Management's Discussion and Analysis of Financial Condition and Results of Operations* under *Forward-Looking Statements*.

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

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**Table of Contents****ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

On June 4, 2007, we held our annual meeting of stockholders at which our stockholders:  
elected Robert L. Antin as a Class II director;

ratified KPMG LLP as our independent auditors; and

approved the VCA Antech, Inc. 2007 Annual Cash Incentive Plan.

The results of the election of the Class II director was as follows:

| <b>Candidate</b> | <b>Yes Votes</b> | <b>No<br/>Votes</b> | <b>Abstain</b> | <b>Broker<br/>Non-Vote</b> |
|------------------|------------------|---------------------|----------------|----------------------------|
| Robert L. Antin  | 67,052,698       |                     | 2,440,376      |                            |

The results of the other matters upon which our stockholders voted were as follows:

| <b>Proposal</b>  | <b>Yes Votes</b> | <b>No Votes</b> | <b>Abstain</b> | <b>Broker<br/>Non-Vote</b> |
|--|------------------|-----------------|----------------|----------------------------|
| Ratify KPMG LLP as our independent auditors                  | 68,942,135       | 509,900         | 41,039         |                            |
| Approve the VCA Antech, Inc. 2007 Annual Cash Incentive Plan | 60,794,944       | 2,810,171       | 64,860         | 5,823,099                  |

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



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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 August 7, 2007.

Date: August 7, 2007

By: /s/ Tomas W. Fuller

Tomas W. Fuller  
Chief Financial Officer

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**EXHIBIT INDEX**

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|--------------------|---|
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