VCA ANTECH INC
Form 10-Q
November 08, 2010

Table of Contents

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

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2010

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission File Number: 001-16783

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o.

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ.

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: common stock, $0.001 par value, 86,174,866 shares as of November 2, 2010.

VCA Antech, Inc. and Subsidiaries
Form 10-Q
September 30, 2010
Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2010	December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 132,233	$ 145,181
Trade accounts receivable, less allowance for uncollectible accounts of $13,448 and $13,015 at September 30, 2010 and December 31, 2009, respectively	51,606	49,186
Inventory	34,580	32,031
Prepaid expense and other	20,785	27,242
Deferred income taxes	19,445	18,318
Prepaid income taxes	15,598	6,252
Total current assets	274,247	278,210
Property and equipment, less accumulated depreciation and amortization of $193,185 and $167,506 at September 30, 2010 and December 31, 2009, respectively	324,222	289,415
Goodwill	1,074,316	985,674
Other intangible assets, net	45,854	44,280
Notes receivable, net	6,216	5,153
Deferred financing costs, net	6,689	581
Other	31,953	24,091
Total assets	$ 1,763,497	$ 1,627,404
Liabilities and Equity		
Current liabilities:		
Current portion of long-term debt	$ 28,202	$ 17,195
Accounts payable	28,464	28,326
Accrued payroll and related liabilities	39,873	33,539
Other accrued liabilities	50,959	43,298
Total current liabilities	147,498	122,358
Long-term debt, less current portion	502,177	527,860
Deferred income taxes	90,089	75,197
Other liabilities	29,307	10,651
Total liabilities	769,071	736,066

Commitments and contingencies		
Preferred stock, par value $0.001, 11,000 shares authorized, none outstanding		
VCA Antech, Inc. stockholders equity:		
Common stock, par value $0.001, 175,000 shares authorized, 86,087 and 85,584 shares outstanding as of September 30, 2010 and December 31, 2009, respectively	86	86
Additional paid-in capital	344,895	335,114
Accumulated earnings	628,780	540,010
Accumulated other comprehensive income (loss)	347	(163)
Total VCA Antech, Inc. stockholders equity	974,108	875,047
Noncontrolling interests	20,318	16,291
Total equity	994,426	891,338
Total liabilities and equity	$ 1,763,497	$ 1,627,404

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

1

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenue	$ 358,703	$ 338,562	$ 1,043,356	$ 999,288
Direct costs	273,404	247,985	781,778	729,194
Gross profit	85,299	90,577	261,578	270,094
Selling, general and administrative expense	27,105	24,695	94,290	70,553
Net loss on sale of assets	152	409	163	5,604
Operating income	58,042	65,473	167,125	193,937
Interest expense, net	3,619	4,808	9,564	16,652
Debt retirement costs	2,550		2,550	
Other income	(180)	(1)	(490)	(131)
Income before provision for income taxes	52,053	60,666	155,501	177,416
Provision for income taxes	23,466	23,180	63,465	68,081
Net income	28,587	37,486	92,036	109,335
Net income attributable to noncontrolling interests	1,156	1,125	3,266	3,259
Net income attributable to VCA Antech, Inc	$ 27,431	$ 36,361	$ 88,770	$ 106,076
Basic earnings per share	$ 0.32	$ 0.43	$ 1.03	$ 1.25
Diluted earnings per share	$ 0.32	$ 0.42	$ 1.02	$ 1.23
Weighted-average shares outstanding for basic earnings per share	86,086	85,217	85,985	84,909
Weighted-average shares outstanding for diluted earnings per share	86,964	86,431	86,998	85,893

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

Table of Contents

VCA Antech, Inc. and Subsidiaries
Condensed, Consolidated Statements of Equity
(Unaudited)
(In thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Earnings	Accumulated Other Comprehensive (Loss) Income	Noncontrolling Interests	Total
Balances, December 31, 2008	84,633	$ 85	$ 308,674	$ 408,582	$ (6,352)	$ 12,846	$ 723,835
Net income				106,076		3,259	109,335
Foreign currency translation adjustment					592		592
Unrealized gain on foreign currency, net of tax					288		288
Unrealized loss on hedging instruments, net of tax					(801)		(801)
Losses on hedging instruments reclassified to income, net of tax					4,791		4,791
Formation of noncontrolling interests						3,440	3,440
Distribution to noncontrolling interests						(3,018)	(3,018)
Restricted stock unit grant			1,941				1,941
Share-based compensation			5,940				5,940
Issuance of common stock under stock incentive plans	808		13,110				13,110
Stock repurchases			(561)				(561)
Tax benefit from stock options and awards			1,445				1,445
Balances, September 30, 2009	85,441	$ 85	$ 330,549	$ 514,658	$ (1,482)	$ 16,527	$ 860,337
Balances, December 31, 2009	85,584	$ 86	$ 335,114	$ 540,010	$ (163)	$ 16,291	$ 891,338
Net income				88,770		3,266	92,036
Foreign currency translation adjustment					103		103
					175		175

Unrealized gain on foreign currency, net of tax							
Unrealized loss on hedging instruments, net of tax					(1)		(1)
Losses on hedging instruments reclassified to income, net of tax					233		233
Formation of noncontrolling interests						4,559	4,559
Distribution to noncontrolling interests						(3,314)	(3,314)
Purchase of noncontrolling interests						(484)	(484)
Share-based compensation			7,490				7,490
Issuance of common stock under stock incentive plans	503		4,781				4,781
Stock repurchases			(2,292)				(2,292)
Tax benefit from stock options and awards			370				370
Tax shortfall and other from stock options and awards			(568)				(568)
Balances, September 30, 2010	86,087	$ 86	$ 344,895	$ 628,780	$ 347	$ 20,318	$ 994,426

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

Table of Contents

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

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash flows from operating activities:		
Net income	$ 92,036	$ 109,335
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	33,387	28,986
Amortization of debt issue costs	461	363
Provision for uncollectible accounts	5,388	5,075
Debt retirement costs	2,550	
Net loss on sale of assets	163	5,604
Share-based compensation	7,490	5,940
Deferred income taxes	10,992	16,057
Excess tax benefit from exercise of stock options	(370)	(591)
Other	(550)	(299)
Changes in operating assets and liabilities:		
Accounts receivable	(7,533)	(8,312)
Inventory, prepaid expense and other assets	(1,754)	(7,820)
Accounts payable and other accrued liabilities	7,038	742
Accrued payroll and related liabilities	3,717	(4,339)
Income taxes	(9,545)	5,580
Net cash provided by operating activities	143,470	156,321
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(45,023)	(51,853)
Real estate acquired in connection with business acquisitions	(5,834)	(3,828)
Property and equipment additions	(47,675)	(38,522)
Proceeds from sale of assets	15	123
Other	188	(440)
Net cash used in investing activities	(98,329)	(94,520)
Cash flows from financing activities:		
Repayment of debt	(548,560)	(5,898)
Proceeds from issuance of long-term debt	500,000	
Payment of financing costs	(9,112)	
Distributions to noncontrolling interest partners	(3,314)	(3,018)
Proceeds from issuance of common stock under stock option plans	4,781	13,110
Excess tax benefit from exercise of stock options	370	591
Stock repurchases	(2,292)	(561)
Net cash (used in) provided by financing activities	(58,127)	4,224

Effect of currency exchange rate changes on cash and cash equivalents	38	17
(Decrease) increase in cash and cash equivalents	(12,948)	66,042
Cash and cash equivalents at beginning of period	145,181	88,959
Cash and cash equivalents at end of period	$ 132,233	$ 155,001
Supplemental disclosures of cash flow information:		
Interest paid	$ 9,207	$ 16,329
Income taxes paid	$ 62,018	$ 46,444
Supplemental schedule of noncash investing and financing activities:		
Detail of acquisitions:		
Fair value of assets acquired	$ 104,251	$ 72,303
Cash paid for acquisitions	(42,827)	(48,042)
Cash paid to bondholders	(29,532)	
Contingent consideration	(259)	(712)
Noncash note conversion to equity interest in subsidiary		(5,700)
Liabilities assumed	$ 31,633	$ 17,849

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

Table of Contents

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements
September 30, 2010
(Unaudited)

1. Nature of Operations

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

Our animal hospitals offer a full range of general medical and surgical services for companion animals. Our animal hospitals treat diseases and injuries, provide pharmaceutical products and perform a variety of pet-wellness programs, including health examinations, diagnostic testing, vaccinations, spaying, neutering and dental care. At September 30, 2010, we operated 523 animal hospitals throughout 40 states.

We operate a full-service veterinary diagnostic laboratory network serving all 50 states and certain areas in Canada. Our laboratory network provides sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. At September 30, 2010, we operated 49 laboratories of various sizes located strategically throughout the United States and Canada.

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

2. Basis of Presentation

Our accompanying unaudited, condensed, consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (GAAP) for interim financial information and in accordance with the rules and regulations of the United States Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements as permitted under applicable rules and regulations. In the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included. The results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the full year ending December 31, 2010. For further information, refer to our consolidated financial statements and notes thereto included in our 2009 Annual Report on Form 10-K.

Certain reclassifications have been made herein to 2009 amounts to conform to the current year presentation. For the three and nine months ended September 30, 2009, we reclassified certain business operations from our Medical Technology segment to our Laboratory segment to conform to the current year presentation; the reclassifications did not have a material impact on either of our segments.

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

3. Multiple-Deliverable Revenue Arrangements

In October 2009, the FASB issued new accounting guidance related to multiple-deliverable revenue arrangements. The new guidance was designed to result in financial reporting that better reflects the underlying economics of multiple-deliverable transactions. We early adopted the new guidance on January 1, 2010, which resulted in the more timely recognition of revenue in our Medical Technology business segment. The early adoption resulted in the recognition of approximately $1.1 million and $3.1 million in incremental revenue for the three and nine months ended September, 2010, respectively, in comparison to the revenue that would have been recognized under previous accounting guidance.

Table of Contents

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

3. Multiple-Deliverable Revenue Arrangements, continued

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

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

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

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

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

The new guidance resulted in a different allocation of revenue to the deliverables in the current fiscal year, which changed the pattern and timing of revenue recognition for these elements but did not change the total revenue to be recognized for the arrangement. Revenue and gross profit increased by approximately $1.1 million and $271,000, respectively, for the three months ending September 30, 2010 and by $3.1 million and $816,000, respectively, for the nine months ending September 30, 2010, primarily as a result of the acceleration of revenue related to the delivery of the equipment in international markets.

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

Table of Contents

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

4. Goodwill and Other Intangible Assets

Goodwill

Goodwill represents the excess of the aggregate of the consideration transferred, the fair value of any noncontrolling interest in the acquiree and for a business combination achieved in stages, the acquisition-date fair value of any previously held equity interest over the net of the fair value of identifiable assets acquired and liabilities assumed. The following table presents the changes in the carrying amount of our goodwill for the nine months ended September 30, 2010 (in thousands):

	Animal Hospital	Laboratory	Medical Technology	Total
Balance as of December 31, 2009	$ 861,868	$ 96,285	$ 27,521	$ 985,674
Goodwill acquired	83,505	7		83,512
Goodwill related to noncontrolling interests	3,237			3,237
Other [(1)]	(756)	507	2,142	1,893
Balance as of September 30, 2010	$ 947,854	$ 96,799	$ 29,663	$ 1,074,316

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

Other Intangible Assets

In addition to goodwill, we have amortizable intangible assets at September 30, 2010 and December 31, 2009 as follows (in thousands):

	As of September 30, 2010			As of December 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Noncontractual customer relationships	$ 45,537	$ (12,464)	$ 33,073	$ 38,359	$ (8,077)	$ 30,282
Covenants not-to-compete	14,039	(7,875)	6,164	14,748	(7,785)	6,963
Favorable lease asset	5,491	(2,524)	2,967	5,406	(2,150)	3,256
Trademarks	3,704	(852)	2,852	3,362	(494)	2,868
Technology	2,189	(1,414)	775	2,209	(1,332)	877
Client lists	35	(12)	23	60	(26)	34
Total	$ 70,995	$ (25,141)	$ 45,854	$ 64,144	$ (19,864)	$ 44,280

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Aggregate amortization expense	$ 2,484	$ 2,013	$ 6,825	$ 5,643

Table of Contents

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

4. Goodwill and Other Intangible Assets, continued

The estimated amortization expense related to intangible assets for the remainder of 2010 and each of the succeeding years thereafter as of September 30, 2010 is as follows (in thousands):

Remainder of 2010	$ 2,631
2011	9,809
2012	8,715
2013	6,504
2014	5,475
Thereafter	12,720
Total	$ 45,854

5. Other Accrued Liabilities

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

	September 30, 2010	December 31, 2009
Deferred revenue	$ 9,397	$ 12,497
Holdbacks	3,236	1,640
Accrued health insurance	4,734	4,484
Deferred rent	3,326	2,989
Accrued workers compensation insurance	1,567	2,217
Customer deposits	3,019	3,783
Other	25,680	15,688
	$ 50,959	$ 43,298

6. Long-Term Obligations

In August 2010, we entered into a new senior credit facility that provided $500.0 million of senior term notes and a $100.0 million revolving credit facility. The terms of the new senior credit facility are discussed in this footnote under *Senior Credit Facility*. The funds borrowed under the new senior term notes were used to retire our existing senior term notes in the principal amount of $505.4 million. In connection with the refinancing transactions, we wrote off previously deferred financing costs and paid financing costs. We incurred $9.4 million in debt retirement costs, of which approximately $2.6 million, or $1.6 million after tax were recognized as part of income from continuing operations and approximately $6.8 million were capitalized as deferred financing costs. Included in the $2.6 million of debt retirement costs included in income from continuing operations was approximately $232,000 in previously deferred financing costs that were written off as part of the transaction. The following table summarizes our long-term obligations at September 30, 2010 and December 31, 2009 (in thousands):

	September 30, 2010	December 31, 2009
Revolver	$	$
Senior term notes (LIBOR + 2.25%)	500,000	
Senior term notes (LIBOR + 1.50%)		516,889

Other debt and capital lease obligations	30,379	28,166
Total debt obligations	530,379	545,055
Less current portion	(28,202)	(17,195)
	$ 502,177	$ 527,860

Table of Contents

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

6. Long-Term Obligations, continued

Senior Credit Facility

In August 2010 we entered into a new senior credit facility with various lenders for $600 million of senior secured credit facilities with Bank of America, N.A. as the syndication agent and Wells Fargo Bank, N.A. as the administrative agent. The senior credit facility includes $500 million of senior term notes and a $100 million revolving credit facility. The revolving credit facility allows us to borrow up to an aggregate principal amount of $100 million and may be used to borrow, on a same-day notice under a swing line, the lesser of $10 million or the aggregate unused amount of the revolving credit facility then in effect. At September 30, 2010 we had no borrowings outstanding under our revolving credit facility.

Interest Rate. In general, borrowings under the senior term notes and the revolving credit facility bear interest, at our option, on either:

the base rate (as defined below); or

the adjusted Eurodollar rate (as defined below) plus a margin of 2.25% (Level III, see table below) per annum until the date of delivery of the compliance certificate and the financial statements for the period ending March 31, 2011, at which time the applicable margin will be determined by reference to the leverage ratio in effect from time to time as set forth in the following table:

Level	Leverage Ratio	Applicable Margin for Eurodollar Rate Loans	Applicable Revolving Commitment Fee %
I	≥ 2.75:1.00	2.75%	0.50%
II	< 2.75:1.00 and ≥ 2.25:1.00	2.50%	0.50%
III	< 2.25:1.00 and ≥ 1.75:1.00	2.25%	0.50%
IV	< 1.75:1.00 and ≥ 1.25:1.00	2.00%	0.50%
V	< 1.25:1.00	1.75%	0.375%

The base rate is a rate per annum equal to the greatest of Wells Fargo s prime rate in effect on such day, the Federal funds effective rate in effect on such day plus 0.50% and the adjusted Eurodollar rate for a one-month interest period commencing on such day plus 1.0%. The adjusted Eurodollar rate is defined as the rate per annum obtained by dividing (1) the rate of interest offered to Wells Fargo on the London interbank market by (2) a percentage equal to 100% minus the stated maximum rate of all reserve requirements applicable to any member bank of the Federal Reserve System in respect of Eurocurrency liabilities.

Maturity and Principal Payments. The senior term notes mature on August 19, 2015. Principal payments on the senior term notes are paid quarterly in the amount of $6.3 million for the first two years beginning on December 31, 2010, quarterly payments of $9.4 million for the two years following, and quarterly payments of $12.5 million for the three quarters prior to maturity at which time the remaining balance is due. The following table sets forth the remaining scheduled principal payments for our senior term notes (in thousands):

2010	$ 6,250
2011	25,000
2012	28,125
2013	37,500
2014	40,625
Thereafter	362,500
Total	$ 500,000

Table of Contents

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

6. Long-Term Obligations, continued

The revolving credit facility matures on August 19, 2015. Principal payments on the revolving credit facility are made at our discretion with the entire unpaid amount due at maturity.

Guarantees and Security. We and each of our wholly-owned subsidiaries guarantee the outstanding debt under the senior credit facility. These borrowings, along with the guarantees of the subsidiaries, are further secured by substantially all of our consolidated assets. In addition, these borrowings are secured by a pledge of substantially all of the capital stock, or similar equity interests, of our wholly-owned subsidiaries.

Debt Covenants. The 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 on all classes of stock. We believe the most restrictive covenant is the fixed charge coverage ratio. At September 30, 2010 we had a fixed charge coverage ratio of 1.57 to 1.00, which was in compliance with the required ratio of no less than 1.20 to 1.00.

Interest Rate Swap Agreements

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

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

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

Credit exposure associated with nonperformance by the counterparties to derivative instruments is generally limited to the uncollateralized fair value of the asset related to instruments recognized in the consolidated balance sheets. We attempt to mitigate the risk of nonperformance by selecting counterparties with high credit ratings and monitoring their creditworthiness and by diversifying derivative amounts with multiple counterparties.

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

As of the quarter ended March 31, 2010, all of our interest rate swap agreements had expired and we have not entered into any new agreements during the quarters ended June 30, 2010 and September 30, 2010.

Table of Contents

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

6. Long-Term Obligations, continued

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Cash paid (1)	$	$1,895	$382	$7,867
Recognized loss (gain) from ineffectiveness (2)	$	$ 1	$	$ (70)

(1) Our interest rate swap agreements effectively converted a certain amount of our variable-rate debt under our senior credit facility to fixed-rate for purposes of hedging against the risk of increasing interests rates. The above table depicts cash payments to the counterparties on our swap agreements. These payments are offset by a corresponding decrease in interest paid on our variable-rate debt under our senior credit facility. These amounts are included in interest expense, net in our condensed, consolidated income statements.

(2) These recognized losses and gains are included in other income in our condensed, consolidated income statements.

7. Fair Value Measurements

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

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

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

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

Fair Value of Financial Instruments

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

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

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

Table of Contents

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

7. Fair Value Measurements, continued

Long-Term Debt. We believe the carrying value of our variable-rate senior term debt at September 30, 2010 is a reasonable estimate of fair value. We believe the carrying value of our variable-rate debt at December 31, 2009 was not a reasonable estimate of fair value due to changes in the credit markets during 2009. We estimated the fair value of our variable-rate debt using discounted cash flow techniques utilizing current market rates, which incorporate our credit risk.

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

	As of September 30, 2010		As of December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Variable-rate long-term debt	$ 500,000	$ 500,000	$ 516,889	$ 513,053

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

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

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

As of September 30, 2010, we do not have any applicable non-recurring measurements of non-financial assets and non-financial liabilities.

8. Share-Based Compensation

Stock Option Activity

A summary of our stock option activity for the nine months ended September 30, 2010 is as follows (in thousands):

	Stock Options	Weighted-Average Exercise Price
Outstanding at December 31, 2009	4,300	$ 16.72
Exercised	(331)	14.41

Cancelled	(48)		19.81
Outstanding at September 30, 2010	3,921	$	16.88
Exercisable at September 30, 2010	3,199	$	16.84
Expected to vest at September 30, 2010	689	$	17.04

Table of Contents

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

8. Share-Based Compensation, continued

There were no stock options granted during the nine months ended September 30, 2010. The aggregate intrinsic value of our stock options exercised during the three and nine months ended September 30, 2010 was $166,000, and $2.1 million, respectively, and the actual tax benefit realized on options exercised during these periods was $64,000 and $827,000, respectively.

At September 30, 2010 there was $1.9 million of total unrecognized compensation cost related to our stock options. This cost is expected to be recognized over a weighted-average period of 1.4 years.

The compensation cost that has been charged against income for stock options for the three months ended September 30, 2010 and 2009 was $414,000 and $471,000, respectively. The corresponding income tax benefit recognized was $161,000 and $183,000 for the three months ended September 30, 2010 and 2009, respectively.

The compensation cost that has been charged against income for stock options for the nine months ended September 30, 2010 and 2009 was $2.2 million and $1.5 million, respectively. The corresponding income tax benefit recognized was $872,000 and $574,000 for the nine months ended September 30, 2010 and 2009, respectively.

Nonvested Stock Activity

There were 240,400 nonvested common stock awards granted to employees during the three and nine months ended September 30, 2010. These awards will vest in equal annual installments over four years from the date of the grant. In addition, during the nine months ended September 30, 2010 we granted 11,104 shares of nonvested common stock to our non-employee directors, which will vest in equal annual installments over three years from the date of grant.

Total compensation cost charged against income related to nonvested stock awards was $1.2 million and $1.5 million for the three months ended September 30, 2010 and 2009, respectively. The corresponding income tax benefit recognized in the income statement was $476,000 and $603,000 for the three months ended September 30, 2010 and 2009, respectively.

Total compensation cost charged against income related to nonvested stock awards was $5.2 million and $4.5 million for the nine months ended September 30, 2010 and 2009, respectively. The corresponding income tax benefit recognized in the income statement was $2.0 and $1.7 million for the nine months ended September 30, 2010 and 2009, respectively.

At September 30, 2010, there was $9.8 million of unrecognized compensation cost related to these nonvested shares, which will be recognized over a weighted-average period of 3.0 years. A summary of our nonvested stock activity for the nine months ended September 30, 2010 is as follows:

	Shares	**Grant Date Weighted-Average Fair Value Per Share**
Outstanding at December 31, 2009	691,764	$ 30.54
Granted	251,504	$ 20.56
Vested	(262,275)	$ 31.79
Forfeited/Canceled	(10,355)	$ 30.35
Outstanding at September 30, 2010	670,638	$ 26.31

Table of Contents

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

8. Share-Based Compensation, continued

Restricted Stock Unit Activity

Pursuant to the terms of the 2006 Equity Incentive Plan, on April 17, 2009, we awarded 84,757 restricted stock units in lieu of cash bonuses to our four senior executive officers for services performed in fiscal year 2008. Restricted stock units differ from the nonvested stock awards mentioned above in that the restricted stock units were fully vested or earned by the employee on the grant date; however, are restricted such that the participant will not have any right, title, or interest in, or otherwise be considered the owner of, any of the shares of common stock covered by the restricted stock units until such shares of common stock are settled. The restricted stock units will be settled upon the first to occur of the following: May 1, 2012, the date of the senior executive s separation from service, death or disability, or the date of a change in control. The restricted stock units had a grant date fair value of $22.90 per share resulting in a total value of $1.9 million and the grant was reported as a non-cash financing activity for the September 30, 2009 period. There were no restricted stock grants for the September 30, 2010 period.

9. Calculation of Earnings per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income attributable to VCA Antech, Inc	$ 27,431	$ 36,361	$ 88,770	$ 106,076
Weighted-average common shares outstanding:				
Basic	86,086	85,217	85,985	84,909
Effect of dilutive potential common shares:				
Stock options	632	951	812	779
Nonvested shares	246	263	201	205
Diluted	86,964	86,431	86,998	85,893
Basic earnings per share	$ 0.32	$ 0.43	$ 1.03	$ 1.25
Diluted earnings per share	$ 0.32	$ 0.42	$ 1.02	$ 1.23

For the three months ended September 30, 2010 and 2009, potential common shares of 1,162,389 and 9,111, respectively, were excluded from the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

For the nine months ended September 30, 2010 and 2009, potential common shares of 13,919 and 1,227,008, respectively, were excluded from the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

Table of Contents

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

10. Comprehensive Income

Total comprehensive income consists of net income and the other comprehensive income during the three and nine months ended September 30, 2010 and 2009. The following table provides a summary of comprehensive income (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	$ 28,587	$ 37,486	$ 92,036	$ 109,335
Other comprehensive income:				
Foreign currency translation adjustments	172	415	103	592
Unrealized gain on foreign currency	364	316	287	473
Tax expense	(142)	(124)	(112)	(185)
Unrealized loss on hedging instruments		(245)	(2)	(1,315)
Tax benefit		96	1	514
Losses on hedging instruments reclassified to income		1,895	382	7,867
Tax benefit		(741)	(149)	(3,076)
Other comprehensive income	394	1,612	510	4,870
Total comprehensive income	28,981	39,098	92,546	114,205
Comprehensive income attributable to noncontrolling interests	1,156	1,125	3,266	3,259
Comprehensive income attributable to VCA Antech, Inc	$ 27,825	$ 37,973	$ 89,280	$ 110,946

11. Lines of Business

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

The accounting policies of our segments are essentially the same as those described in the summary of significant accounting policies included in our 2009 Annual Report on Form 10-K. See Note 3, *Multiple-Deliverable Revenue Arrangements*, for an update on our revenue recognition policies as a result of implementing the FASB s accounting guidance on multiple-deliverable revenue arrangements. We evaluate the performance of our segments based on gross profit and operating income. For purposes of reviewing the operating performance of our segments all intercompany sales and purchases are generally accounted for as if they were transactions with independent third parties at current market prices.

Table of Contents

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

11. Lines of Business, continued

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

	Animal Hospital	Laboratory (1)	Medical Technology (1)	Corporate	Intercompany Eliminations	Total (1)
Three Months Ended September 30, 2010						
External revenue	$ 276,739	$ 67,872	$ 14,092	$	$	$ 358,703
Intercompany revenue		9,420	3,314		(12,734)	
Total revenue	276,739	77,292	17,406		(12,734)	358,703
Direct costs	230,113	42,579	12,152		(11,440)	273,404
Gross profit	46,626	34,713	5,254		(1,294)	85,299
Selling, general and administrative expense	5,599	6,804	3,731	10,971		27,105
Net loss on sale and disposal of assets	114	20	17	1		152
Operating income (loss)	$ 40,913	$ 27,889	$ 1,506	$ (10,972)	$ (1,294)	$ 58,042
Depreciation and amortization	$ 8,258	$ 2,464	$ 606	$ 616	$ (263)	$ 11,681
Capital expenditures	$ 16,969	$ 1,599	$ 428	$ 1,394	$ (640)	$ 19,750