VCA ANTECH INC
Form 10-Q
November 08, 2005

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

FORM 10-Q

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

For the quarterly period ended September 30, 2005

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 x No o.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
Yes x No 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 x.

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 82,628,370 shares as of November 4, 2005.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

VCA ANTECH, INC. AND SUBSIDIARIES
CONDENSED, CONSOLIDATED BALANCE SHEETS
As of September 30, 2005 and December 31, 2004
(Unaudited)
(In thousands, except par value)

	September 30, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 44,501	$ 30,964
Restricted cash		1,250
Trade accounts receivable, less allowance for uncollectible accounts of $8,817 and $7,668 at September 30, 2005 and December 31, 2004, respectively	33,764	28,936
Inventory	17,407	10,448
Prepaid expenses and other	7,673	6,275
Deferred income taxes	12,847	11,472
Prepaid income taxes	2	10,830
Total current assets	116,194	100,175
Property and equipment, less accumulated depreciation and amortization of $89,956 and $79,139 at September 30, 2005 and December 31, 2004, respectively	146,970	119,903
Other assets:		
Goodwill	579,637	499,144
Other intangible assets, net	11,328	11,660
Deferred financing costs, net	1,405	4,052
Other	7,404	7,166
Total assets	$ 862,938	$ 742,100
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term obligations	$ 5,826	$ 6,043
Accounts payable	19,294	15,566
Accrued payroll and related liabilities	18,389	19,850
Accrued interest	327	1,578
Other accrued liabilities	30,350	21,874
Total current liabilities	74,186	64,911
Long-term obligations, less current portion	448,254	390,846
Deferred income taxes	27,425	31,514
Other liabilities	13,761	12,915
Minority interest	10,257	9,155

Commitments and contingencies				
Preferred stock, par value $0.001, 11,000 shares authorized, none outstanding				
Stockholders equity:				
Common stock, par value $0.001, 175,000 shares authorized, 82,576 and 82,191 shares outstanding as of September 30, 2005 and December 31, 2004, respectively		83		82
Additional paid-in capital		255,493		251,412
Retained earnings (deficit)		32,006		(18,759)
Accumulated other comprehensive income		1,474		34
Notes receivable from stockholders		(1)		(10)
Total stockholders equity		289,055		232,759
Total liabilities and stockholders equity	$	862,938	$	742,100

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 Nine Months Ended September 30, 2005 and 2004
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Revenue	$ 229,242	$ 183,352	$ 622,689	$ 497,649
Direct costs	166,598	133,571	448,783	358,304
Gross profit	62,644	49,781	173,906	139,345
Selling, general and administrative expense	18,394	13,037	47,943	33,503
Loss (gain) on sale of assets	115	(12)	27	54
Operating income	44,135	36,756	125,936	105,788
Interest expense, net	6,034	6,629	18,782	18,712
Debt retirement costs			19,282	810
Other (income) expense	(130)	(9)	1	(185)
Minority interest in income of subsidiaries	778	746	2,309	1,917
Income before provision for income taxes	37,453	29,390	85,562	84,534
Provision for income taxes	15,196	12,046	34,797	34,279
Net income	$ 22,257	$ 17,344	$ 50,765	$ 50,255
Basic earnings per common share	$ 0.27	$ 0.21	$ 0.62	$ 0.62
Diluted earnings per common share	$ 0.26	$ 0.21	$ 0.61	$ 0.60
Shares used for computing basic earnings per share	82,526	81,944	82,364	81,701
Shares used for computing diluted earnings per share	84,019	83,455	83,818	83,300

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 Nine Months Ended September 30, 2005 and 2004
(Unaudited)
(In thousands)

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Cash flows from operating activities:		
Net income	$ 50,765	$ 50,255
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,947	11,407
Amortization of debt costs	482	552
Provision for uncollectible accounts	2,996	2,190
Debt retirement costs	19,282	810
Loss on sale of assets and other	(310)	(296)
Tax benefit from stock options exercised	2,333	3,542
Minority interest in income of subsidiaries	2,309	1,917
Distributions to minority interest partners	(1,968)	(1,505)
Changes in operating assets and liabilities:		
Increase in accounts receivable	(7,009)	(5,075)
Increase in inventory, prepaid expenses and other assets	(5,796)	(909)
Increase in accounts payable and other accrued liabilities	6,311	1,759
Decrease in accrued payroll and related liabilities	(5,734)	(677)
Increase (decrease) in accrued interest	(1,251)	4,107
Decrease (increase) in prepaid income taxes	10,828	(1,173)
Increase in deferred income tax assets	(1,375)	(823)
Increase in deferred income tax liabilities	5,404	5,654
Net cash provided by operating activities	91,214	71,735
Cash flows used in investing activities:		
Business acquisitions, net of cash acquired	(83,702)	(97,152)
Real estate acquired in connection with business acquisitions	(2,929)	(5,565)
Property and equipment additions	(22,725)	(16,035)
Proceeds from sale of assets	368	184
Other	3,540	1,553
Net cash used in investing activities	(105,448)	(117,015)
Cash flows from financing activities:		
Repayment of long-term obligations, including tender fees	(445,721)	(147,691)
Proceeds from the issuance of long-term obligations	475,000	225,000
Payment of financing costs	(3,257)	(794)
Proceeds from issuance of common stock under stock option plans	1,749	2,362

Net cash provided by financing activities	27,771	78,877
Increase in cash and cash equivalents	13,537	33,597
Cash and cash equivalents at beginning of period	30,964	17,237
Cash and cash equivalents at end of period	$ 44,501	$ 50,834

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
September 30, 2005
(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 adjustments, consisting of 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, 2005 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 2004 annual report on Form 10-K.

2. Acquisitions

We acquired the following animal hospitals during the nine months ended September 30, 2005 and 2004:

	Nine Months Ended September 30,	
	2005	**2004**
Acquisitions, excluding NPC and Pet s Choice (1)(2)	19	17
Pet s Choice (1)	46	
NPC (2)		67
Acquisitions relocated into our existing animal hospitals	(5)	(4)
Total	60	80

(1) Pet s Choice, Inc., or Pet s Choice, was acquired on July 1, 2005.

(2) National PetCare Centers, Inc., or NPC, was acquired on June 1, 2004.

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Animal Hospital Acquisitions, excluding NPC and Pet s Choice

The following table summarizes the aggregate consideration, including acquisition costs, paid by us for our acquired animal hospitals, excluding NPC and Pet s Choice, and the allocation of the purchase price (in thousands):

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Consideration:		
Cash	$ 28,466	$ 28,063
Notes payable and other liabilities assumed	1,706	1,457
Total	$ 30,172	$ 29,520
Purchase Price Allocation:		
Goodwill (1)	$ 27,178	$ 26,439
Identifiable intangible assets	1,755	1,645
Tangible assets	1,239	1,436
Total	$ 30,172	$ 29,520

(1) We expect that $20.3 million of the goodwill recorded during the nine months ended September 30, 2005, will be fully deductible for income tax purposes.

Pet s Choice, Inc.

On July 1, 2005, we acquired Pet s Choice, which operated 46 animal hospitals located in five states as of the acquisition date. This acquisition allowed us to expand our animal hospital operations in five states, particularly Texas and Washington. Our condensed, consolidated financial statements reflect the operating results of Pet s Choice for the period of July 1, 2005 through September 30, 2005.

As of September 30, 2005, we had not finalized the purchase price accounting for the Pet s Choice acquisition, as we are awaiting final billing on due diligence fees and certain legal fees are still being incurred, and the valuation of certain tax assets and liabilities has not been finalized. In addition, Pet s Choice will refund a portion of the purchase price to us in accordance with the terms of the purchase agreement requiring Pet s Choice to maintain a certain level of working capital at July 1, 2005. All of these items will result in a change to the total purchase price.

The total consideration, excluding the potential integration costs and the working capital adjustment, as of September 30, 2005, was $77.3 million, consisting of: $51.5 million in cash paid to holders of Pet s Choice stock and debt; $14.1 million in assumed debt; $9.3 million in assumed liabilities; $1.2 million of operating leases whose terms were in excess of market; $810,000 paid for professional and other outside services; and $460,000 paid as part of our plan to close the Pet s Choice corporate office and terminate certain employees. The $77.3 million purchase price was allocated as follows: $51.8 million to goodwill; $266,000 to identifiable intangible assets; and $25.2 million to tangible assets, including real estate in the amount of $1.2 million. We expect that $21.8 million of the goodwill recorded will be fully deductible for income tax purposes.

National PetCare Centers, Inc.

On June 1, 2004, we acquired National PetCare Centers, Inc., or NPC, which operated 67 animal hospitals located in 11 states as of the merger date. This merger allowed us to expand our animal hospital operations in nine states, particularly California and Texas, and to expand into two new states, Oregon and Oklahoma.

The total consideration for this acquisition was $89.3 million, consisting of: $66.2 million in cash paid to holders of NPC stock and debt; $2.5 million in assumed debt; $11.7 million in assumed liabilities; $4.5 million of operating leases whose terms were in excess of market; $2.0 million paid for professional and other outside services;

and $2.4 million paid as part of our plan to close certain facilities and terminate certain employees. The $89.3 million purchase price was allocated as follows: $75.0 million to goodwill; $1.4 million to identifiable intangible assets; and $12.9 million to tangible assets, including real estate in the amount of $5.0 million. We expect that $30.0 million of the goodwill recorded will be fully deductible for income tax purposes.

Partnership Interests

We purchased the ownership interests in certain partially-owned subsidiaries of our company from partners of these subsidiaries. The following table summarizes the consideration paid by us and the amount of goodwill recorded for these acquisitions (in thousands):

	Nine Months Ended September 30,	
	2005	**2004**
Consideration:		
Cash	$ 568	$ 1,106
Notes payable and other liabilities assumed	399	221
Total	$ 967	$ 1,327
Goodwill recorded (1)	$ 709	$ 846

(1) We expect that the goodwill recorded in the nine months ended September 30, 2005 will be fully deductible for income tax purposes.

Other Acquisition Payments

We paid $1.1 million and $864,000 to sellers for the unused portion of holdbacks during the nine months ended September 30, 2005 and 2004, respectively.

We paid $2.0 million and $325,000 during the nine months ended September 30, 2005 and 2004, respectively, for earnout targets that were met and recorded goodwill in the same amounts. Earnout payments are discussed under note 9, *Commitments and Contingencies.*

In June 2004, we paid $2.3 million to settle the remaining obligation to a seller in connection with a prior year acquisition.

Sound Technologies, Inc.

On October 1, 2004, we acquired Sound Technologies, Inc., or STI, which is a supplier of ultrasound and digital radiography equipment and related computer hardware, software and services to the veterinary industry. Under the terms of the purchase agreement, we may be obligated to pay after September 30, 2005, up to $2.0 million of additional purchase price if certain performance targets are met.

The total consideration, excluding the $2.0 million contingent obligation described above, was $30.9 million, consisting of: $23.9 million in cash paid to holders of STI stock; $1.1 million in assumed debt; $5.5 million in assumed liabilities; and $380,000 paid for professional and other outside services. The allocation of the $30.9 million purchase price was allocated as follows: $19.8 million to goodwill; $4.7 million to identifiable intangible assets; and

$6.4 million to tangible assets. We expect that $389,000 of the goodwill recorded will be fully deductible for income tax purposes.

3. Long-Term Obligations

In May 2005, we entered into a new senior credit facility that provided $475.0 million of senior term notes and a $75.0 million revolving credit facility. The terms of the new senior credit facility are discussed below 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 $220.3 million and our 9.875% senior subordinated notes in the principal amount of $170.0 million. In connection with the refinancing transactions, we wrote off deferred financing costs

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and paid financing costs, including an aggregate tender fee of $13.8 million to purchase the 9.875% senior subordinated notes. Total debt retirement costs approximated $19.3 million. The new senior term notes also provided the necessary financing to acquire Pet s Choice, which is discussed in note 2, *Acquisitions*. The following table summarizes our long-term obligations at September 30, 2005 and December 31, 2004 (in thousands):

	September 30, 2005	**December 31, 2004**
Revolver	$	$
Senior term notes (LIBOR + 1.50%)	437,713	
Senior term notes (LIBOR + 1.75%)		223,313
9.875% senior subordinated notes		170,000
Other debt and capital lease obligations	16,367	3,576
Total debt obligations	$ 454,080	$ 396,889

The following table sets forth the scheduled maturities of our long-term obligations for each of the five succeeding years and thereafter as of September 30, 2005 (in thousands):

Remainder of 2005	$ 1,626
2006	5,650
2007	6,791
2008	5,584
2009	5,349
Thereafter	429,080
Total	$ 454,080

Senior Credit Facility

Our $550.0 million senior credit facility is comprised of various lenders with Goldman Sachs Credit Partners, L.P. as the syndication agent and Wells Fargo Bank, N.A. as the administrative agent. The senior credit facility includes $475.0 million of senior term notes and a $75.0 million revolving credit facility. The revolving credit facility allows us to borrow up to an aggregate principal amount of $75.0 million and may be used to borrow, on a same-day notice under a swing line, the lesser of $5.0 million or the aggregate unused amount of the revolving credit facility then in effect. At September 30, 2005, we had no borrowings outstanding under our revolving credit facility.

In August 2005, we prepaid $35.0 million of our senior term notes.

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) plus a margin of 0.50% per annum; or

the adjusted Eurodollar rate (as defined below) plus a margin of 1.50% per annum.

Swing line borrowings bear interest at the base rate (as defined below) plus a margin of 0.50% per annum.

The base rate is the higher of Wells Fargo s prime rate or the Federal funds rate plus 0.50%. 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 May 16, 2011. Principal payments on the senior term notes are paid quarterly in the amount of $1.1 million with the remaining balance due at maturity. The following table sets forth the remaining scheduled principal payments for our senior term notes as of September 30, 2005 (in thousands):

Remainder of 2005	$ 1,100
2006	4,399
2007	4,399
2008	4,399
2009	4,399
Thereafter	419,017
Total	$ 437,713

The revolving credit facility matures on May 16, 2010. Principal payments on the revolving credit facility are made at our discretion with the entire unpaid amount due at maturity.

Starting December 31, 2005, as defined in the senior credit facility, mandatory prepayments are due on the senior term notes equal to 75% of any excess cash flow at the end of each fiscal year. Excess cash flow is defined as earnings before interest, taxes, depreciation and amortization less voluntary and scheduled debt repayments, capital expenditures, interest payable in cash, taxes payable in cash and cash paid for acquisitions. These payments reduce on a pro rata basis the remaining scheduled principal payments. All outstanding indebtedness under the senior credit facility may be voluntarily prepaid in whole or in part without premium or penalty.

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. At September 30, 2005, we had a fixed charge coverage ratio of 1.54 to 1.00, which was in compliance with the required ratio of no less than 1.20 to 1.00, and a leverage ratio of 2.54 to 1.00, which was in compliance with the required ratio of no more than 3.25 to 1.00.

4. Interest Rate Hedging Agreements

We have no-fee swap agreements whereby we pay to the counterparties amounts based on fixed interest rates and set notional principal amounts in exchange for the receipt of payments from counterparties based on current LIBOR and the same set notional principal amounts. A summary of these agreements is as follows:

Fixed interest rate	4.07%	3.98%	3.94%
Notional principal amount	$50.0 million	$50.0 million	$50.0 million
Effective date	5/26/2005	6/2/2005	6/30/2005
Expiration date	5/26/2008	5/31/2008	6/30/2007
Counterparties	Goldman Sachs	Wells Fargo Bank	Wells Fargo Bank
Qualifies for hedge accounting	Yes	Yes	Yes

We also had two other swap agreements that expired on May 31, 2005. One agreement had a notional principal amount of $20.0 million with a fixed interest rate of 1.72%, and the other agreement had a notional principal amount of $20.0 million with a fixed interest rate of 1.51%.

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The following table summarizes our cash payments (receipts) and unrealized loss (gain) recognized as a result of our interest rate hedging agreements (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Cash paid (received) (1)	$ 190	$ 90	$ 75	$ 419
Unrealized loss (gain) (2)	$ (130)	$ (9)	$ 1	$ (185)

(1) These payments are included in interest expense in our condensed, consolidated income statements.

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

The valuations of our swap agreements were determined by the counterparties based on fair market valuations for similar agreements. The fair market value of our swap agreements resulted in assets of $1.6 million and $178,000 at September 30, 2005 and December 31, 2004, respectively. These amounts are included in prepaid expenses and other in our accompanying condensed, consolidated balance sheets.

5. Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to identifiable assets acquired and liabilities assumed.

The following table presents the changes in the carrying amount of our goodwill by segment for the nine months ended September 30, 2005 (in thousands):