

VCA ANTECH INC  
Form 10-K  
February 29, 2008

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

**Form 10-K**

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

**For the fiscal year ended December 31, 2007  
or**

**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**

*(State or other jurisdiction of  
incorporation or organization)*

**12401 West Olympic Boulevard,  
Los Angeles, California**

*(Address of principal executive offices)*

**95-4097995**

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

**90064-1022**

*(Zip code)*

**(310) 571-6500**

*Registrant's telephone number, including area code:*

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

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
Common Stock, par value \$0.001 per share	Nasdaq Global Select Market

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

**None**

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☐.

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

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

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

(Do not check if a  
smaller reporting  
company)

Smaller reporting  
company ☐

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

The aggregate market value of the voting common equity held by non-affiliates as of June 30, 2007, was approximately \$3.1 billion, computed by reference to the price of \$37.69 per share, the price at which the common equity was last sold on such date as reported on the NASDAQ Global Select Market. For purposes of this computation, it is assumed that the shares beneficially held by directors and officers of the registrant would be deemed to be stock held by affiliates. Non-affiliated common stock outstanding at June 30, 2007 was 81,635,716 shares.

Total common stock outstanding at February 27, 2008 was 84,703,529 shares.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Parts of the definitive Proxy Statement to be delivered to stockholders in connection with the 2008 Annual Meeting of Stockholders are incorporated by reference into Items 10, 11, 12, 13 and 14 hereof.

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**Forward-Looking Statements**

This annual report on Form 10-K 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, seek, expect, estimate, may, plan, should plan, project, could, predict, potential, continue, or similar expressions. You may find 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 include those items discussed in *Risk Factors* in Item 1A of this annual report.

**PART I**

**ITEM 1. BUSINESS**

**Company Overview**

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

Our network of veterinary diagnostic laboratories provides sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. Our network of veterinary diagnostic laboratories provides diagnostic testing for over 16,000 clients, which includes standard animal hospitals, large animal practices, universities and other government organizations. Our animal hospitals offer a full range of general medical and surgical services for companion animals, as well as specialized treatments including advanced diagnostic services, internal medicine, oncology, ophthalmology, dermatology and cardiology. In addition, we provide pharmaceutical products and perform a variety of pet wellness programs including health examinations, diagnostic testing, routine vaccinations, spaying, neutering and dental care. Our network of animal hospitals is supported by more than 1,500 veterinarians and had over 6.1 million patient visits in 2007. Our medical technology business sells digital radiography and ultrasound imaging equipment, provides education and training on the use of that equipment, and provides consulting and mobile imaging services.

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

**Company History**

Our company was formed in 1986 as a Delaware corporation and during the 1990s established a position in the veterinary diagnostic laboratory and animal hospital markets through both internal growth and acquisitions. By December 31, 1999, our company had built a laboratory network of 13 laboratories servicing animal hospitals in all 50 states and operated a total of 194 animal hospitals. Subsequent to 1999, our company continued its growth by adding additional laboratories and through the acquisition of individually owned animal hospitals and the following animal hospital chains:

On June 1, 2004, we acquired National PetCare Centers, Inc. ( NPC ), which operated 67 animal hospitals as of the acquisition date. This acquisition allowed us to expand our animal hospital operations, particularly in California and Texas.

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On July 1, 2005, we acquired Pet's Choice, Inc. ( Pet's Choice ), which operated 46 animal hospitals as of the acquisition date. This acquisition allowed us to expand our animal hospital operations, particularly in Texas and Washington.

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

Subsequent to 1999, we also acquired and opened additional laboratories that service locations with a high level of demand (i.e., large metropolitan areas). In addition, on October 1, 2004, we acquired Sound Technologies, Inc. ( STI ), which is a supplier of digital radiography and ultrasound imaging equipment and related computer hardware, software and services to the veterinary industry. The acquisition of STI provided us the opportunity to sell digital imaging equipment, which we believe is an emerging and dynamic segment within the animal healthcare industry.

## **Industry Overview**

According to American Pet Products Manufacturers Association, Inc. ( APPMA ), the United States population of companion animals in 2006 reached approximately 215 million, including about 163 million dogs and cats. APPMA estimates that over \$21 billion was spent in the United States on pets in 2006 for veterinary care, supplies, medicine and boarding and grooming. The APPMA National Pet Owners' Survey indicated that the ownership of pets is widespread and growing with over 71 million, or 63%, of U.S. households owning at least one pet, including companion and other animals. Specifically, 45 million households owned at least one dog and 38 million households owned at least one cat.

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

Even as treatments available in veterinary medicine become more complex, prices for veterinary services typically remain a low percentage of a pet owner's income, facilitating payment at the time of service. Unlike the human healthcare industry, providers of veterinary services are not dependent on third-party payers in order to collect fees. As such, providers of veterinary services typically do not have the problems of extended payment collection cycles or pricing pressures from third-party payers faced by human healthcare providers. Outsourced laboratory testing and diagnostic equipment sales are wholesale businesses that collect payments directly from animal hospitals under standard industry payment terms. Fees for services provided in our animal hospitals are due at the time of service. For example, in 2007 over 95% of our animal hospital services were paid at the time of service. In addition, over the past three fiscal years our bad debt expense has averaged only 1% of total revenue.

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



***Diagnostic Laboratory Industry***

Veterinarians use laboratory tests to treat animals by diagnosing and monitoring illnesses and conditions through the detection of substances in urine, tissue, fecal and blood samples, and other specimens. As is the

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case with the physician treating a human patient, laboratory diagnostic testing is becoming a routine diagnostic tool used by the veterinarian.

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

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

We believe that the outsourced laboratory testing market is among the faster growing segments of the animal healthcare industry as a result of:

- the increased focus on wellness, early detection and monitoring programs in veterinary medicine, which is increasing the overall number of tests being performed;

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

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

## ***Animal Hospital Industry***

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

According to the American Veterinary Medical Association, the U.S. market for veterinary services is highly fragmented with more than 49,000 veterinarians practicing at over 22,000 companion animal hospitals at the end of 2006. Although most animal hospitals are single-site, sole-practitioner facilities, we believe veterinarians are gravitating toward larger, multi-doctor animal hospitals that provide state-of-the-art facilities, treatments, methods and pharmaceuticals to enhance the services they can provide their clients.

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

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

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

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

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

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

### ***Medical Technology Industry***

Veterinarians use radiography and ultrasound imaging equipment to capture and view anatomical images to aid in the diagnosis and treatment of a broad range of diseases and injuries in animals. Digital radiography imaging equipment utilizes high frequency electromagnetic waves to capture x-ray images that are then digitized and stored in digital format. Ultrasound imaging equipment utilizes high frequency sound waves and echoes to display a two-dimensional image of the tissue being examined. Veterinarians can display images created by digital radiography and ultrasound imaging equipment on computer monitors, manipulate the images, store them electronically and transmit them in digital format over the Internet with additional computer hardware and software.

We believe that the use of digital radiography and ultrasound imaging equipment provides advantages to veterinarians when compared to other imaging equipment for the following reasons:

the ability to see greater detail and manipulate images, which assists in the diagnosis of illnesses and injuries and improves the quality of care;

the ability to transmit images over the Internet to facilitate consultation with a specialist;

improved efficiencies, including the ability to easily store and retrieve images electronically; and

the reduction of costs associated with the purchasing, processing, storing, filing and retrieving of conventional film used by traditional x-ray equipment.

### **Business Strategy**

Our business strategy is to continue expanding our market leadership in animal healthcare through our diagnostic laboratory, animal hospital and medical technology segments. Key elements to our strategy include:

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

**Leveraging Established Infrastructure to Improve Margins.** We intend to leverage our established laboratory and animal hospital infrastructure to continue to increase our operating margins. Due to our

established networks and the fixed cost nature of our business model, we are able to realize high margins on incremental revenue from laboratory and animal hospital customers. For example, given that our nationwide transportation network servicing our laboratory customers is a relatively fixed cost, we are able to achieve significantly higher margins on most incremental tests ordered by the same customer when picked up by our couriers at the same time.

**Utilizing Enterprise-Wide Information Systems to Improve Operating Efficiencies.** Our laboratory and the majority of our animal hospital operations utilize enterprise-wide management information

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systems. We believe that these common systems enable us to more effectively manage the key operating metrics that drive our business. With the aid of these systems, we seek to standardize pricing, expand the services our veterinarians provide, capture unbilled services and increase volume through targeted marketing programs.

**Pursuing Selected Acquisitions.** The fragmentation of the animal hospital industry provides us with significant expansion opportunities in our animal hospital segment. Depending upon the attractiveness of the candidates and the strategic fit with our existing operations, we intend to acquire independent animal hospitals each year with aggregate annual revenues of approximately \$50.0 million to \$60.0 million. Our overall acquisition strategy involves the identification of high-quality practices where we can create additional value through the services and scale we can provide. Our typical candidate mirrors the profile of our existing hospital base. These acquisitions will be used to both expand existing markets and to enter into new geographic areas. In addition, we also evaluate the acquisition of animal hospital chains, laboratories or related businesses if favorable opportunities are presented. We intend primarily to use cash in our acquisitions but, depending on the timing and amount of our acquisitions, we may use stock or debt.

## **Business Segments**

We report our results of operations through three segments: Laboratory, Animal Hospital and Medical Technology.

Information regarding revenue and operating income, attributable to each of our segments, is included in the *Segment Results* section within *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and within Note 2.c, *Revenue and Related Cost Recognition*, of our Notes to Consolidated Financial Statements, which are incorporated herein by reference.

### **Laboratories**

We operate a full-service, veterinary diagnostic laboratory network serving all 50 states. Our laboratory revenue accounted for 26% of total consolidated revenue in 2007, 2006, and 2005. We service a diverse customer base of over 16,000 clients including animal hospitals we operate, which accounted for 9% of total laboratory revenue in both 2007 and 2006 and 8% in 2005.

### **Services**

Our diagnostic spectrum includes over 300 different tests in the area of chemistry, pathology, endocrinology, serology, hematology and microbiology, as well as tests specific to particular diseases. We do not conduct experiments on animals.

Although modified to address the particular requirements of the species tested, the tests performed in our veterinary laboratories are similar to those performed in human clinical laboratories and utilize similar laboratory equipment and technologies. We believe that the growing concern for animal health, combined with the movement of veterinary medicine toward increasing specialization, may result in the migration of additional areas of human testing into the veterinary field.

Given the recent advancements in veterinary-medical technology and the increased breadth and depth of knowledge required for the practice of veterinary medicine, many veterinarians solicit the knowledge and experience of our specialists to interpret test results to aid in the diagnosis of illnesses and to suggest possible treatment alternatives. Our diagnostic experts include veterinarians, chemists and other scientists with expertise in pathology, internal medicine, oncology, cardiology, dermatology, neurology and endocrinology. Because of our specialist support, we believe the quality of our service further distinguishes our laboratory services as a premiere service provider.



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### ***Laboratory Network***

At December 31, 2007, we operated 36 veterinary diagnostic laboratories. Our laboratory network includes:

primary hubs that are open 24 hours per day and offer a full-testing menu;

secondary laboratories that are open 24 hours per day and offer a wide-testing menu servicing large metropolitan areas; and

STAT laboratories that service other locations with demand sufficient to warrant nearby laboratory facilities and are open primarily during daytime hours.

We connect our laboratories to our customers with what we believe is the industry's largest transportation network, picking up requisitions daily through an extensive network of drivers and independent couriers. Customers outside our transportation network use FedEx to send specimens to our laboratory just outside of Memphis, Tennessee, which permits rapid and cost-efficient testing because of the proximity to the primary sorting facility of FedEx.

In 2007, we derived 70% of our laboratory revenue from major metropolitan areas, where we offer twice-a-day pick-up service and same-day results. In addition, in these areas we generally offer to report results within three hours of pick-up. Outside of these areas, we typically provide test results to veterinarians before 8:00 a.m. the day following pick-up.

### ***Sales, Marketing and Client Service***

Our full-time sales and field-service representatives market laboratory services and maintain relationships with existing customers. Our sales force is commission-based and organized along geographic regions. We support our sales efforts by strengthening our industry-leading team of specialists, developing marketing literature, attending trade shows, participating in trade associations and providing educational services to veterinarians. Our client-service representatives respond to customer inquiries, provide test results and, when appropriate, introduce the customer to other services offered by the laboratory.

### ***Personnel***

Each of our primary and secondary laboratory locations includes a manager, supervisors for each department and personnel for laboratory testing. In addition, we employ or contract with specialists to interpret test results to assist veterinarians in the diagnosis of illnesses and to suggest possible treatment alternatives.

We actively recruit qualified personnel and are committed to supporting continuing education for our professional staff. We have internal training programs for routine testing procedures to improve the skill level of our technicians and to improve the overall capacity of our existing staff. We sponsor various internship and certain other educational programs. These programs serve to build awareness of our company with respect to students, whom after graduation may seek employment with our company.

### ***Animal Hospitals***

At December 31, 2007, we operated 438 animal hospitals serving 38 states. Our animal hospital revenue accounted for approximately 73% of total consolidated revenue in 2007, 2006, and 2005.

### ***Services***



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

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

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

has annual revenue between \$1.0 million and \$2.5 million;

is supported by three to five veterinarians; and

has an operating history of over ten years.

As of December 31, 2007, our nationwide network of freestanding, full-service animal hospitals had facilities located in the following states:

California	77	Ohio*	7
Texas*	43	Alaska	5
Washington*	31	Georgia	5
Florida	28	New Mexico	5
Massachusetts	24	North Carolina*	5
New York*	22	Minnesota*	5
Illinois	17	Delaware	4
Pennsylvania	17	Hawaii	3
Virginia	16	Nebraska*	3
Arizona	15	Wisconsin	3
Connecticut	13	Louisiana*	2
Colorado	11	Missouri	2
New Jersey*	11	South Carolina	2
Indiana	10	Vermont	2
Michigan	10	Alabama*	1
Oregon*	10	New Hampshire*	1
Maryland	9	Rhode Island*	1
Nevada	8	Utah	1
Oklahoma	8	West Virginia*	1

\* States with laws that prohibit corporations from providing veterinary-medical care. In these states we provide administrative and support services to veterinary-medical groups pursuant to management agreements.

***Marketing***

We primarily direct our marketing efforts toward our existing clients through customer education efforts. We inform and educate our clients about pet wellness and quality care through mailings of Healthy Pet Magazine, which focuses on pet care and wellness. We also market through targeted demographic mailings regarding specific pet health issues and collateral health material available at each animal hospital. With these internal marketing programs, we seek to leverage our existing customer base by increasing the number and intensity of the services received during each visit. We send reminder notices to increase awareness of the advantages of regular, comprehensive veterinary-medical care,

including preventive care such as wellness exams, vaccinations, dental screening and geriatric care. We also enter into referral arrangements with local pet shops, humane societies and veterinarians to increase our client base. We seek to obtain referrals from veterinarians by promoting our specialized diagnostic and treatment capabilities to veterinarians and veterinary practices that cannot offer their clients these services.

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### ***Personnel***

Our animal hospitals generally employ a staff of between 10 and 30 full-time-equivalent employees, depending upon the facility's size and customer base. The staff includes administrative and technical-support personnel, three to five veterinarians, a hospital manager who supervises the day-to-day activities of the facility, and a small office staff.

We actively recruit qualified veterinarians and technicians and are committed to supporting continuing education for our professional staff. We operate post-graduate teaching programs for veterinarians at 14 of our facilities, which train approximately 110 veterinarians each year. We believe that these programs enhance our reputation in the veterinary profession and further our ability to continue to recruit the most talented veterinarians.

We seek to establish an environment that supports the veterinarian in the delivery of quality medicine and fosters professional growth through increased patient flow and a diverse case mix, continuing education, state-of-the-art equipment and access to specialists. We believe our hospitals offer attractive employment opportunities to veterinarians because of our professional environment, competitive compensation, management opportunities, employee benefits not generally available to a sole practitioner, flexible work schedules that accommodate personal lifestyles and the ability to relocate to different regions of the country.

We have established a medical advisory board to support our operations. Our advisory board, under the direction of our Chief Medical Officer, recommends medical standards for our network of animal hospitals and is comprised of veterinarians recognized for their outstanding knowledge and reputations in the veterinary field. Our advisory board members represent both the different geographic regions in which we operate and the medical specialties practiced by our veterinarians; and three members are faculty members at highly-ranked veterinary colleges. Additionally, our regional medical directors, a group of highly experienced clinicians, are also closely involved in the development and implementation of our medical programs.

### **Medical Technology**

Our medical technology segment sells digital radiography and ultrasound imaging equipment and related computer hardware, software and services, including consulting services and training, to the veterinary market. Our digital radiography and ultrasound imaging equipment are used by veterinarians to capture and view anatomical images to aid in the diagnosis and treatment of a broad range of diseases and injuries in animals. We also have developed and license VetPACS, our proprietary software package that allows for the archival and communication of digital images, image manipulation, networking, case reporting and image and case transmission over the Internet. In addition, we have mobile imaging units that provide mobile diagnostic ultrasound imaging services to veterinarians who do not own their own ultrasound imaging equipment. Medical technology revenue accounted for 4% of our consolidated revenue in 2007, 2006 and 2005.

### ***Products & Services***

We sell digital radiography imaging equipment, which is comprised of a network of various components that we acquire from third-party manufacturers and developers. A key component is the amorphous silicon flat-panel x-ray detector, which we acquire from Varian Medical Systems pursuant to a distribution agreement entered into in February 2008, granting us worldwide rights to incorporate these detectors into veterinary digital imaging equipment for sale to the veterinary community, and the exclusive right to do so in North America.

We sell General Electric ultrasound imaging equipment pursuant to an agreement entered into with General Electric in July 2001 granting us exclusive rights to sell this equipment to members and institutions in the North American veterinary community.

We license our proprietary software, VetPACS and TruDR. VetPACS enables the archival and communication of digital images, image manipulation, networking, case reporting and image and case transmission over the Internet. TruDR allows for the capture of digital x-ray images and transmits those images to a computer containing VetPACS. TruDR, or similar software, is a required component for our digital radiography imaging

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equipment to function. TruDR is not applicable to ultrasound imaging equipment sales. Our ultrasound imaging equipment is functional without VetPACS; however, without VetPACS, or similar software, there is no digital capability, such as electronic storage or transmission.

We also provide mobile imaging, consulting, education and training services to our customers. In addition, we sell extended service agreements to our customers that include technical support, product updates for software and extended warranty coverage for a period of up to five years. The products included in our warranty programs are generally covered by the original equipment manufacturer and we coordinate the warranty support between our customer and the manufacturer.

## ***Sales and Marketing***

Our sales agents market and sell our products and services to veterinary hospitals and universities. Our sales agents receive a base salary and commissions based on sales. We market our products and services through direct mail, advertisements in trade magazines, trade shows and direct sales calls to our intended customers.

## **Systems**

### ***Laboratory***

We use an enterprise-wide management information system to support our veterinary laboratories. All of our financial, customer records and laboratory results are stored in computer databases. Laboratory technicians and specialists are able to electronically access test results from remote testing sites. Our software gathers data in a data warehouse enabling us to provide expedient results via fax or through our Internet online resulting system.

### ***Animal Hospital***

We use an enterprise-wide management information system to support our animal hospital operations. We decide whether or not to place newly acquired animal hospitals on this network based on a cost-benefit analysis. In addition, a majority of our animal hospitals utilize consistent patient accounting/point-of-sale software and we are able to track performance of hospitals on a per-service, per-veterinarian and per-client basis.

## **Competition**

Among veterinary diagnostic laboratories, we believe that quality, price, specialist support and the time required to deliver results are the major competitive factors. There are many clinical laboratories that provide a broad range of diagnostic testing services in the same markets serviced by us, and we also face competition from several providers of on-site diagnostic equipment that allows veterinarians to perform various testing. Our principal competitor in most geographic locations in the United States is IDEXX Laboratories.

The companion animal healthcare industry is highly competitive and subject to continual change in the manner in which services are delivered and providers are selected. We believe that the primary factors influencing a customer's selection of an animal hospital are convenient location and hours, recommendation of friends, reasonable fees and quality of care. Our primary competitors for our animal hospitals in most markets are individual practitioners or small, regional multi-clinic practices. In addition, some national companies in the pet care industry, including the operators of super-stores, are developing networks of animal hospitals in markets that include our animal hospitals.

The primary competitive factors in the medical imaging equipment industry are quality, technical capability, breadth of product line, distribution capabilities, price and the ability to provide quality service and support. There are many

companies that manufacture and sell digital radiography and ultrasound imaging equipment.

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### **Government Regulation**

Certain states have laws that prohibit business corporations from providing, or holding themselves out as providers of, veterinary-medical care. In these states we do not provide veterinary services or own veterinary practices. We provide management and other administrative services to veterinary practices located in these states. At December 31, 2007, we provided management services to 143 animal hospitals in 14 states under management agreements with the veterinary practices. In one of these states, we operated a mobile imaging service. Although we seek to structure our operations to comply with veterinary medicine laws of each state in which we operate, given the varying and uncertain interpretations of these laws, we may not be in compliance with restrictions on the corporate practice of veterinary medicine in all states. A determination that we are in violation of applicable restrictions on the practice of veterinary medicine in any state in which we operate could have a material adverse effect on our operations, particularly if we were unable to restructure our operations to comply with the requirements of that state.

In addition, all of the states in which we operate impose various registration requirements. To fulfill these requirements, we have registered each of our facilities with appropriate governmental agencies and, where required, have appointed a licensed veterinarian to act on behalf of each facility. All veterinarians practicing in our clinics are required to maintain valid state licenses to practice.

Our acquisitions may be subject to pre-merger or post-merger review by governmental authorities for anti-trust and other legal compliance. Adverse regulatory action could negatively affect our operations through the assessment of fines or penalties against us or the possible requirement of divestiture of one or more of our operations.

### **Employees**

At December 31, 2007, we employed or managed on behalf of our professional corporations 8,600 full-time-equivalent employees. At that date, none of these employees were a party to a collective bargaining agreement.

### **Website Availability of Our Reports Filed with the Securities and Exchange Commission**

We maintain a website with the address <http://investor.vcaantech.com>. We are not including the information contained on our website as a part of, or incorporating it by reference into, this annual report on Form 10-K. We make available free of charge through our website our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file that material with, or furnish that material to, the SEC.

### **ITEM 1A. RISK FACTORS**

Various sections of this annual report contain forward-looking statements, all of which are based on current expectations and could be affected by the uncertainties and risk factors described below and through this annual report. Our actual results may differ materially from these forward-looking statements.

*If we are unable to effectively execute our growth strategy, we may not achieve our desired economies of scale and our profitability may decline.*

Our success depends in part on our ability to increase our revenues and operating income through a balanced program of internal growth initiatives and selective acquisitions of established animal hospitals, laboratories and related businesses. If we cannot implement or effectively execute on this strategy, our results of operations will be adversely affected. Even if we effectively implement our growth strategy, we may not achieve the economies of scale that we



have experienced in the past or that we anticipate having in the future. Our internal growth rate may decline and could become negative. Our laboratory internal revenue growth, adjusted for differences in billing days, has fluctuated between 9.8% and 15.2% for 2003 through 2007. Our animal hospital same-store revenue growth, adjusted for differences in business days, has fluctuated between 3.6% and 6.6% over the same years. Our internal growth may continue to fluctuate and may be below our

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historical rates. Any reduction in the rate of our internal growth may cause our revenues and operating income to decrease. Investors should not assume that our historical growth rates are reliable indicators of results in future periods.

### ***Changes in the demand for our products and services could negatively affect our operating results.***

Client visits may be negatively impacted as a result of preventative care and better pet nutrition. Demand for vaccinations will be impacted in the future as protocols for vaccinations change. Our veterinarians establish their own vaccine protocols. Some of our veterinarians have changed their protocols and others may change their protocols in light of recent and/or future literature. The demand for our products and services may also decline as a result of the eradication or substantial declines in the prevalence of certain diseases.

The frequency of visits to our animal hospitals has declined and may continue to decline. We believe that the frequency of visits is impacted by several trends in the industry. Demand for pet-related products traditionally sold at animal hospitals have become more widely available in retail stores and other channels of distribution, including the Internet. Some professionals in the industry have recommended that vaccinations be given less frequently. We believe that, historically, the animal healthcare industry and our business have been relatively resistant to changes in the general economy, but not immune to them. However, our fourth quarter results appear to indicate that we were marginally impacted by the uncertainty in the economy. As a result of these factors, during the fourth quarter, and particularly the second half of the quarter, our internal revenue growth slowed. If demand for our products, vaccinations or other veterinary and laboratory services continue to decline, our operating results will be negatively impacted.

### ***Due to the fixed cost nature of our business, fluctuations in our revenue could adversely affect our gross profit, operating income and margins.***

A substantial portion of our expenses, particularly rent and personnel costs, are fixed costs and are based in part on expectations of revenue. We may be unable to reduce spending in a timely manner to compensate for any significant fluctuations in our revenue. Accordingly, shortfalls in revenue may adversely affect our gross profit, operating income and margins.

### ***Any failure in our information technology systems, disruption in our transportation network or failure to receive supplies could significantly increase testing turn-around time, reduce our production capacity and otherwise disrupt our operations.***

Our laboratory operations depend on the continued and uninterrupted performance of our information technology systems and transportation network, including overnight delivery services provided by FedEx. Sustained system failures or interruption in our transportation network could disrupt our ability to process laboratory requisitions, perform testing, provide test results in a timely manner and/or bill the appropriate party. We could lose customers and revenue as a result of a system or transportation network failure. In addition, any change in government regulation related to transportation samples or specimens could also have an impact on our business.

Our computer systems are vulnerable to damage or interruption from a variety of sources, including telecommunications failures, electricity brownouts or blackouts, malicious human acts and natural disasters. Moreover, despite network security measures, some of our servers are potentially vulnerable to physical or electrical break-ins, computer viruses and similar disruptive problems. Despite the precautions we have taken, unanticipated problems affecting our systems could cause interruptions in our information technology systems. Our insurance policies may not adequately compensate us for any losses that may occur due to any failures in our systems.

Our laboratory operations depend on a limited number of employees to upgrade and maintain its customized computer systems. If we were to lose the services of some or all of these employees, it may be time-consuming for new employees to become familiar with our systems, and we may experience disruptions in service during these periods.

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Our operations depend, in some cases, on the ability of single source suppliers or a limited number of suppliers, to deliver products and supplies on a timely basis. Some of the products that we purchase from these suppliers are proprietary, and, therefore, cannot be readily or easily replaced by alternative suppliers. We have in the past experienced, and may in the future experience, shortages of or difficulties in acquiring products and/or supplies in the quantities and of the quality needed. Shortages in the availability of products and/or supplies for an extended period of time will disrupt our ability to deliver products and provide services in a timely manner, could result in the loss of customers, and could have a material adverse impact on our results of operations.

### ***Difficulties integrating new acquisitions may impose substantial costs and cause other problems for us.***

Our success depends on our ability to timely and cost-effectively acquire, and integrate into our business, additional animal hospitals and in some instances laboratories and related businesses. In 2007, we acquired 73 animal hospitals and two laboratories, including 44 animal hospitals as part of the acquisition of Healthy Pet Corp. In 2006, we acquired 22 animal hospitals and three laboratories. In 2005, we acquired 68 animal hospitals, including 46 animal hospitals as part of the acquisition of Pet's Choice, Inc. We expect to continue our animal hospital acquisition program and if presented with favorable opportunities, we may acquire animal hospital chains, laboratories or related businesses. Our expansion into new territories and new business segments creates the risk that we will be unsuccessful in the integration of the acquired businesses that are new to our operations. Any difficulties in the integration process could result in increased expense, loss of customers and a decline in profitability. In some cases, we have experienced delays and increased costs in integrating acquired businesses, particularly where we acquire a large number of animal hospitals in a single region at or about the same time. We also could experience delays in converting the systems of acquired businesses into our systems, which could result in increased staff and payroll expense to collect our results as well as delays in reporting our results, both for a particular region and on a consolidated basis. Further, the legal and business environment prevalent in new territories and with respect to new businesses may pose risks that we do not anticipate and adversely impact our ability to integrate newly acquired operations. In addition, our field management may spend a greater amount of time integrating these new businesses and less time managing our existing businesses. During these periods, there may be less attention directed to marketing efforts or staffing issues, which could affect our revenues and expenses. For all of these reasons, our historical success in integrating acquired businesses is not a reliable indicator of our ability to do so in the future. If we are not successful in timely and cost-effectively integrating future acquisitions, it could result in decreased revenue, increased costs and lower margins.

We continue to face risks in connection with our acquisitions including:

negative effects on our operating results;

impairments of goodwill and other intangible assets;

dependence on retention, hiring and training of key personnel, including specialists; and

contingent and latent risks associated with the past operations of, and other unanticipated problems arising in, an acquired business.

The process of integration may require a disproportionate amount of the time and attention of our management, which may distract management's attention from its day-to-day responsibilities. In addition, any interruption or deterioration in service resulting from an acquisition may result in a customer's decision to stop using us. For these reasons, we may not realize the anticipated benefits of an acquisition, either at all or in a timely manner. If that happens and we incur significant costs, it could have a material adverse impact on our business.



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***The significant competition in the companion animal healthcare industry could result in a decrease in our prices, an increase in our acquisition costs, a loss of market share and could materially affect our revenue and profitability.***

The companion animal healthcare industry is highly competitive with few barriers to entry. To compete successfully, we may be required to reduce prices, increase our acquisition and operating costs or take other measures that could have an adverse effect on our financial condition, results of operations, margins and cash flow. In addition, if we are unable to compete successfully, we may lose market share.

There are many clinical laboratory companies that provide a broad range of laboratory testing services in the same markets we service. These companies have acquired additional laboratories in the markets in which we operate and may continue their expansion, and aggressively bundle their products and services to compete with us. Increased competition may adversely affect our laboratory revenues and margins. Several other national companies develop and sell on-site diagnostic equipment that allows veterinarians to perform their own laboratory tests. Growth of the on-site diagnostic testing market may have an adverse effect on our laboratory revenue.

Our primary competitors for our animal hospitals in most markets are individual practitioners or small, regional, multi-clinic practices. Also, regional pet care companies and some national companies, including operators of super-stores, are developing multi-regional networks of animal hospitals in markets in which we operate. Historically, when a competing animal hospital opens in proximity to one of our hospitals, we have reduced prices, expanded our facility, retained additional qualified personnel, increased our marketing efforts or taken other actions designed to retain and expand our client base. As a result, our revenue may decline and our costs may increase. In addition, shifts in the purchasing habits of networks of hospitals could result in limiting or discontinuing the use of our laboratories.

A significant component of our annual growth strategy includes the acquisition of independent animal hospitals with aggregate annual revenues of \$50.0 million to \$60.0 million. The competition for animal hospital acquisitions from small national and regional multi-clinic companies may cause us to increase the amount we pay to acquire additional animal hospitals and may result in fewer acquisitions than anticipated by our growth strategy. If we are unable to acquire a requisite number of animal hospitals annually or if our acquisition costs increase, we may be unable to effectively implement our growth strategy and realize anticipated economies of scale.

Our medical technology division is a relatively new entrant in the market for medical imaging equipment in the animal healthcare industry. Our primary competitors are companies that are much larger than us and have substantially greater capital, manufacturing, marketing and research and development resources than we do, including companies such as Siemens Medical Systems, Philips Medical Systems and Canon Medical Systems. The success of our medical technology division, in part, is due to its focus on the veterinary market, which allows it to differentiate its products and services to meet the unique needs of this market. If this market receives more focused attention from these larger competitors, we may find it difficult to compete and as a result our revenues and operating margins could decline. If we fail to compete successfully in this market, the demand for our products and services would decrease. Any reduction in demand could lead to fewer customer orders, pricing pressures, reduced revenues, reduced margins, reduced levels of profitability and loss of market share. These competitive pressures could adversely affect our business and operating results.

***The carrying value of our goodwill and other intangible assets could be subject to an impairment write-down.***

At December 31, 2007, our consolidated balance sheet reflected \$822.0 million of goodwill and \$22.4 million of other intangible assets, constituting a substantial portion of our total assets of \$1.3 billion at that date. We expect that the aggregate amount of goodwill and other intangible assets on our consolidated balance sheet will increase as a result of future acquisitions. We continually evaluate whether events or circumstances have occurred that suggest that the fair

value of our other intangible assets or each of our reporting units are below their respective carrying values. The determination that the fair value of our intangible assets or one of our reporting units is less than its carrying value may result in an impairment write-

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down. The impairment write-down would be reflected as expense and could have a material adverse effect on our results of operations during the period in which we recognize the expense. Upon completion of our annual review in 2007, we concluded that the fair values of our reporting units exceeded their respective carrying values and accordingly, as of that date, our goodwill as reflected in our consolidated financial statements was not impaired. However, in the future we may incur impairment charges related to the goodwill and other intangible assets already recorded or arising out of future acquisitions.

***We require a significant amount of cash to service our debt and expand our business as planned.***

We have, and will continue to have, a substantial amount of debt. Our substantial amount of debt requires us to dedicate a significant portion of our cash flow from operations to pay down our indebtedness and related interest, thereby reducing the funds available to use for capital expenditures, acquisitions and general corporate purposes.

At December 31, 2007, our debt consisted of:

\$527.7 million in principal amount outstanding under our senior term notes; and

\$32.5 million in principal amount outstanding under capital leases and other debt.

Our ability to make payments on our debt, and to fund acquisitions, will depend upon our ability to generate cash in the future. Insufficient cash flow could place us at risk of default under our debt agreements or could prevent us from expanding our business as planned. Our ability to generate cash is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Our business may not generate sufficient cash flow from operations, our strategy to increase operating efficiencies may not be realized and future borrowings may not be available to us under our senior credit facility in an amount sufficient to enable us to service our debt or to fund our other liquidity needs. A substantial portion of our debt is variable-rate debt that is exposed to interest rate fluctuations. In order to meet our debt obligations, we may need to refinance all or a portion of our debt. We may not be able to refinance any of our debt on commercially reasonable terms or at all.

***Our failure to satisfy covenants in our debt instruments will cause a default under those instruments.***

In addition to imposing restrictions on our business and operations, our debt instruments include a number of covenants relating to financial ratios and tests. Our ability to comply with these covenants may be affected by events beyond our control, including prevailing economic, financial and industry conditions. The breach of any of these covenants would result in a default under these instruments. An event of default would permit our lenders and other debtholders to declare all amounts borrowed from them to be due and payable, together with accrued and unpaid interest. Moreover, these lenders and other debtholders would have the option to terminate any obligation to make further extensions of credit under these instruments. If we are unable to repay debt to our senior lenders, these lenders and other debtholders could proceed against our assets.

***Our debt instruments may adversely affect our ability to run our business.***

Our substantial amount of debt, as well as the guarantees of our subsidiaries and the security interests in our assets and those of our subsidiaries, could impair our ability to operate our business effectively and may limit our ability to take advantage of business opportunities. For example, our senior credit facility may:

limit our ability to borrow additional funds or to obtain other financing in the future for working capital, capital expenditures, acquisitions, investments and general corporate purposes;



limit our ability to dispose of our assets, create liens on our assets or to extend credit;

make us more vulnerable to economic downturns and reduce our flexibility in responding to changing business and economic conditions;

limit our flexibility in planning for, or reacting to, changes in our business or industry;

place us at a competitive disadvantage to our competitors with less debt; and

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restrict our ability to pay dividends, repurchase or redeem our capital stock or debt, or merge or consolidate with another entity.

The terms of our senior credit facility allow us, under specified conditions, to incur further indebtedness, which would heighten the foregoing risks. If compliance with our debt obligations materially hinders our ability to operate our business and adapt to changing industry conditions, we may lose market share, our revenue may decline and our operating results may suffer.

***Any failure by the manufacturers of our medical imaging equipment, failure in our ability to develop functional and cost-effective software for our products, or any product malfunctions could result in a decline in customer purchases and a reduction in our revenue and profitability.***

We do not develop or manufacture the medical imaging equipment that we distribute, except for the software component of our digital radiography machines. Our business in large part is dependent upon distribution agreements with the manufacturers of the equipment, the ability of those manufacturers to produce desirable equipment and to keep pace with advances in technology, our ability to develop cost-effective, functional, and user-friendly software for the digital radiography machines, and the overall rate of new development within the industry. If the distribution agreements terminate or are not renewed, if the manufacturers breach their covenants under these agreements, if the equipment manufactured by these manufacturers or our software becomes less competitive or if there is a general decrease in the rate of new development within the industry, demand for our products and services would decrease. In addition, because the products represent a significant capital investment for our customers, an adverse change in the economy or the current tax law could also negatively impact the demand for these products and services. Any reduction in demand could lead to fewer customer orders, pricing pressures, reduced revenues, reduced margins, reduced levels of profitability and loss of market share.

Manufacturing flaws, component failures, design defects, or inadequate disclosure of product-related information could result in an unsafe condition or injury. These problems could result in product liability claims and lawsuits alleging that our products have resulted or could result in an unsafe condition or injury. In addition, an adverse event involving one of our products could result in reduced market acceptance and demand for all of our products, and could harm our reputation and our ability to market our products in the future. Any of the foregoing problems could disrupt our business and have a material adverse effect on our business, results of operations, financial condition and cash flows.

***Our use of self-insurance, self-insured retention and high-deductible insurance programs to cover certain claims for losses suffered and costs or expenses incurred could negatively impact our business upon the occurrence of an uninsured and/or significant event.***

We self-insure and use high retention or high deductible insurance programs with regard to property risks, general, professional and employment practice liabilities, health benefits, including executive post-retirement health benefits, and workers' compensation when the lack of availability and/or the high cost of commercially available insurance products do not render the transfer of this risk economically feasible. In the event that the frequency of losses experienced by us increased unexpectedly, the aggregate of such losses could materially increase our liability and adversely affect our financial condition, liquidity, cash flows and results of operations. In addition, while the insurance market continues to limit the availability of certain insurance products while increasing the costs of such products, we will continue to evaluate the levels of claims we include in our self-insured, self-insured retention and/or high-deductible insurance programs. Any increases to these programs increase our risk of exposure and therefore increases the risk of a possible material adverse effect on our financial condition, liquidity, cash flows and results of operations. In addition, we have made certain judgments as to the limits on our existing insurance coverage that we

believe are in line with industry standards, as well as in light of economic and availability considerations. Unforeseen catastrophic loss scenarios could prove our limits to be inadequate, and losses incurred in connection with the known claims we self-insure could be substantial. Either of these circumstances could materially adversely affect our financial and business condition.

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***We may experience difficulties hiring skilled veterinarians due to shortages that could disrupt our business.***

As the pet population continues to grow, the need for skilled veterinarians continues to increase. If we are unable to retain an adequate number of skilled veterinarians, we may lose customers, our revenue may decline and we may need to sell or close animal hospitals. At December 31, 2007, there were 28 veterinary schools in the country accredited by the American Veterinary Medical Association. These schools graduate approximately 2,100 veterinarians per year. There is a shortage of skilled veterinarians in some regional markets in which we operate animal hospitals. During shortages in these regions, we may be unable to hire enough qualified veterinarians to adequately staff our animal hospitals, in which event we may lose market share and our revenues and profitability may decline.

***If we fail to comply with governmental regulations applicable to our business, various governmental agencies may impose fines, institute litigation or preclude us from operating in certain states.***

The laws of many states prohibit business corporations from providing, or holding themselves out as providers of, veterinary-medical care. At December 31, 2007, we operated 143 animal hospitals in 14 states with these laws, including 43 in Texas, 31 in Washington and 22 in New York. In addition, our mobile imaging service also operates in states with these laws. We may experience difficulty in expanding our operations into other states with similar laws. Given varying and uncertain interpretations of the veterinary laws of each state, we may not be in compliance with restrictions on the corporate practice of veterinary medicine in all states. A determination that we are in violation of applicable restrictions on the practice of veterinary medicine in any state in which we operate could have a material adverse effect on us, particularly if we are unable to restructure our operations to comply with the requirements of that state.

All of the states in which we operate impose various registration requirements. To fulfill these requirements, we have registered each of our facilities with appropriate governmental agencies and, where required, have appointed a licensed veterinarian to act on behalf of each facility. All veterinarians practicing in our clinics are required to maintain valid state licenses to practice.

***We may have to write-off certain capitalized software development costs.***

If we are unable to realize the benefits of internally developed software, we may be required to write-off a portion or all of the associated capitalized costs, which may have an adverse effect on our operating results in the period in which we incur the write-off. We are currently in the process of internally developing software that will be used in our animal hospitals. Costs related directly to the software design, coding, testing and installation are capitalized and will be amortized over the expected life of the software when it is deployed.

***The loss of Mr. Robert Antin, our Chairman, President and Chief Executive Officer, could materially and adversely affect our business.***

We are dependent upon the management and leadership of our Chairman, President and Chief Executive Officer, Robert Antin. We have an employment contract with Mr. Antin that may be terminated at the option of Mr. Antin. We do not maintain any key man life insurance coverage for Mr. Antin. The loss of Mr. Antin could materially adversely affect our business.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our corporate headquarters and principal executive offices are located in Los Angeles, California, in approximately 50,000 square feet of leased space. At February 27, 2008, we leased or owned facilities at 509 other locations that house our animal hospitals, laboratories and medical technology group. We own

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92 facilities and the remainder are leased. We believe that our real property facilities are adequate for our current needs.

**ITEM 3. LEGAL PROCEEDINGS**

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

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

No matters were submitted to a vote of our security holders during the fourth quarter of 2007.

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

Our common stock trades on the NASDAQ Global Select Market under the symbol WOOF. The following table sets forth the range of high and low sales prices per share for our common stock as quoted on the NASDAQ Global Select Market for the periods indicated.

	<b>High</b>	<b>Low</b>
Fiscal 2007 by Quarter		
Fourth	\$ 46.23	\$ 40.34
Third	\$ 42.90	\$ 36.22
Second	\$ 42.00	\$ 35.96
First	\$ 39.98	\$ 31.54
Fiscal 2006 by Quarter		
Fourth	\$ 36.48	\$ 30.65
Third	\$ 36.57	\$ 30.30
Second	\$ 33.34	\$ 26.74
First	\$ 29.94	\$ 26.62

At February 27, 2008, there were 206 holders of record of our common stock.

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The following graph sets forth the percentage change in cumulative total stockholder return of our common stock from December 31, 2002 to December 31, 2007. These periods are compared with the cumulative returns of the NASDAQ Stock Market (U.S. Companies) Index and the Russell 2000 Index. The comparison assumes \$100 was invested on December 31, 2002 in our common stock and in each of the foregoing indices. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***

Among VCA Antech, Inc., The NASDAQ Composite Index  
and The Russell 2000 Index

\* \$100 invested on 12/31/02 in stock or index-including reinvestment of dividends. Fiscal year ending December 31.

	12/02	12/03	12/04	12/05	12/06	12/07
VCA Antech, Inc.	100.00	206.53	260.53	376.00	429.20	589.73
NASDAQ Composite	100.00	149.75	164.64	168.60	187.83	205.22
Russell 2000	100.00	147.25	174.24	182.18	215.64	212.26

**Dividends**

We have not paid cash dividends on our common stock, and we do not anticipate paying cash dividends in the foreseeable future. In addition, our senior credit facility places limitations on our ability to pay cash dividends in respect of our common stock. Any future determination as to the payment of dividends on our common stock will be restricted by these limitations, will be at the discretion of our Board of Directors and will depend on our results of operations, financial condition, capital requirements and other factors deemed relevant by the Board of Directors, including the General Corporation Law of the State of Delaware, which provides that dividends are only payable out of surplus or current net profits.

**Transactions in Our Equity Securities**

For the period covered by this report, we have not engaged in any transactions involving the sale of our unregistered equity securities that were not disclosed in a quarterly report on Form 10-Q or a current report on Form 8-K, and neither we, nor our affiliated purchasers have purchased any of our equity securities. We have not engaged in any sales of registered securities for which the use of proceeds is required to be disclosed.



**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

The following table provides our selected consolidated financial data as of and for each of the years in the five- year period ended December 31, 2007. The statements of operations and cash flows data and the other data for each of the three years ended December 31, 2007, and the balance sheet data as of December 31, 2007 and 2006 has been derived from our audited financial statements included elsewhere in this Form 10-K. The other periods presented were derived from our audited financial statements that are not included in this Form 10-K.

The selected financial data presented below is not necessarily indicative of results of future operations and should be read in conjunction with the *Management's Discussion and Analysis of Financial Condition and Results of Operations* section and our consolidated financial statements and related notes included elsewhere in this 10-K.

	December 31,				
	2007	2006	2005	2004	2003
	(In thousands, except per share amounts)				
Income Statement Data:					
Laboratory revenue	\$ 295,695	\$ 258,345	\$ 222,064	\$ 200,441	\$ 178,812
Animal hospital revenue	844,344	711,997	607,565	481,023	376,040
Medical technology revenue(1)	46,823	39,305	30,330	6,090	
Intercompany	(30,717)	(26,334)	(20,293)	(13,465)	(10,187)
Total revenue	1,156,145	983,313	839,666	674,089	544,665
Direct costs	834,724	712,749	613,799	490,558	394,853
Gross profit(3)	321,421	270,564	225,867	183,531	149,812
Selling, general and administrative expense	86,877	78,020	66,185	48,257	38,702
Write-down and loss on sale of assets	1,323	17	441	59	590
Operating income(4)	233,221	192,527	159,241	135,215	110,520
Interest expense, net	29,503	24,240	25,043	25,492	26,087
Debt retirement costs			19,282	880	9,118
Other expense (income)	315	8	(122)	(338)	(118)
Income before minority interest and provision for income taxes	203,403	168,279	115,038	109,181	75,433
Minority interest in income of subsidiaries	3,755	3,100	3,109	2,558	1,633
Income before provision for income taxes	199,648	165,179	111,929	106,623	73,800
Provision for income taxes(2)	78,636	59,650	44,113	43,051	30,377
Net income	\$ 121,012	\$ 105,529	\$ 67,816	\$ 63,572	\$ 43,423
Basic earnings per share	\$ 1.44	\$ 1.27	\$ 0.82	\$ 0.78	\$ 0.54

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Diluted earnings per share	\$	1.41	\$	1.24	\$	0.81	\$	0.76	\$	0.53
Weighted-average shares outstanding for basic earnings per share		83,893		83,198		82,439		81,794		80,480
Weighted-average shares outstanding for diluted earnings per share		85,716		84,882		83,996		83,361		81,746

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	2007	2006	December 31, 2005 (In thousands)	2004	2003
<b>Other Financial Data:</b>					
Consolidated gross margin(3)	27.8%	27.5%	26.9%	27.2%	27.5%
Laboratory gross margin(3)	48.4%	46.2%	44.5%	43.8%	42.4%
Animal hospital gross margin(3)	19.3%	19.4%	19.5%	19.4%	19.7%
Medical technology gross margin(1)(3)	33.9%	36.2%	31.1%	36.2%	
Consolidated operating margin(4)	20.2%	19.6%	19.0%	20.1%	20.3%
Laboratory operating margin(4)	41.7%	39.5%	38.2%	37.5%	35.9%
Animal hospital operating margin(4)	16.6%	16.6%	16.7%	16.8%	16.9%
Medical technology operating margin(1)(4)	9.1%	8.8%	1.3%	6.0%	
<b>Cash Flow Data:</b>					
Net cash provided by operating activities	\$ 170,376	\$ 126,890	\$ 115,100	\$ 86,359	\$ 76,107
Net cash used in investing activities	\$ (271,305)	\$ (87,732)	\$ (115,431)	\$ (149,869)	\$ (47,162)
Net cash provided by (used in) financing activities	\$ 166,691	\$ (52,542)	\$ 27,855	\$ 77,237	\$ (18,170)
Capital expenditures	\$ 48,714	\$ 35,316	\$ 29,209	\$ 23,954	\$ 15,433
<b>Balance Sheet Data (at period end):</b>					
Cash and cash equivalents	\$ 110,866	\$ 45,104	\$ 58,488	\$ 30,964	\$ 17,237
Goodwill	\$ 821,967	\$ 625,748	\$ 586,444	\$ 499,144	\$ 373,238
Total assets	\$ 1,286,711	\$ 971,957	\$ 898,405	\$ 742,100	\$ 554,803
Long-term debt	\$ 560,180	\$ 390,715	\$ 452,712	\$ 396,889	\$ 317,469
Total stockholders' equity	\$ 568,384	\$ 430,305	\$ 308,751	\$ 232,759	\$ 161,923

- (1) On October 1, 2004, we acquired Sound Technologies Inc. ( STI ), a supplier of digital radiography and ultrasound imaging equipment to the veterinary industry.
- (2) The 2006 provision for income taxes includes a \$6.8 million tax benefit recognized in the first quarter due to the outcome of an income tax audit that resulted in a reduction in our estimated tax liabilities.
- (3) In 2007, our gross profit was favorably impacted by a \$3.2 million decrease in our estimated workers compensation insurance liability for policy periods prior to 2007. This benefit impacted our consolidated gross margin, laboratory gross margin, animal hospital gross margin and medical technology gross margin by 0.3%, 0.2%, 0.3% and 0.1%, respectively.
- (4) In 2007, our operating income was favorably impacted by \$3.5 million for a decrease in our estimated workers compensation insurance liability for policy periods prior to 2007. This benefit impacted our consolidated

operating margin, laboratory operating margin, animal hospital operating margin and medical technology operating margin by 0.3%, 0.2%, 0.3% and 0.1%, respectively.

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### **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion should be read in conjunction with our consolidated financial statements provided under Part II, Item 8 of this annual report on Form 10-K. 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, seek, expect, estimate, may, should plan, project, contemplate, anticipate, predict, potential, continue, or similar expressions. You may find 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 annual report and particularly in Risk Factors Part I, Item 1A of this annual report on Form 10-K.*

*The forward-looking information set forth in this annual report on Form 10-K is as of February 27, 2008, and we undertake no duty to update this information. Shareholders and prospective investors can find information filed with the SEC after February 27, 2008, at our website at <http://investor.vcaantech.com> or at the SEC's website at [www.sec.gov](http://www.sec.gov).*

#### **Overview**

We are a leading national animal healthcare company. We provide veterinary services and diagnostic testing services to support veterinary care and we sell diagnostic imaging equipment and other medical technology products and related services to veterinarians. Our 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 December 31, 2007, our laboratory network consisted of 36 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 December 31, 2007, our animal hospital network consisted of 438 animal hospitals in 38 states.

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

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

#### **Executive Overview**

The last several years have been marked by continued growth in our operating segments achieved through a combination of organic growth and acquisitions. Our laboratory internal revenue growth, adjusted for differences in billing days, was 13.5% and 15.2% in 2007 and 2006, respectively. Our animal hospital same-store revenue growth, adjusted for differences in business days, was 5.2% and 5.8% in 2007 and 2006,

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respectively. Our medical technology segment also experienced growth through the sale of its digital radiography imaging equipment.

Our acquisition of independent animal hospitals for the last three years was augmented by the acquisition of two animal hospital chains including: Healthy Pet Corp. ( Healthy Pet ) in 2007 and Pet's Choice, Inc. ( Pet's Choice ) in 2005 both of which are discussed in greater detail below.

***Acquisitions and Facilities***

Our annual growth strategy includes the acquisition of independent animal hospitals. In 2007, we acquired 29 independent animal hospitals with annual revenue of \$57.0 million. In addition, we also evaluate the acquisition of animal hospital chains, laboratories or related businesses if favorable opportunities are presented. The following table summarizes the changes in the number of facilities operated by our laboratory and animal hospital segments:

	<b>For The Years Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Laboratories:			
Beginning of period	33	31	27
Acquisitions	2	3	
Acquisitions relocated into our existing laboratories	(1)	(2)	
New facilities	2	1	4
End of period	36	33	31
Animal hospitals:			
Beginning of period	379	367	315
Acquisitions, excluding Healthy Pet and Pet's Choice(1)(2)	29	22	22
Healthy Pet(1)	44		
Pet's Choice(2)			46
Acquisitions relocated into our existing animal hospitals	(7)	(5)	(6)
Sold or closed	(7)	(5)	(10)
End of period	438	379	367

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

(2) Pet's Choice was acquired on July 1, 2005.

***Acquisition of Healthy Pet***

On June 1, 2007, we acquired Healthy Pet, which operated at the time of its acquisition, 44 animal hospitals and a small laboratory, which primarily serviced its own animal hospitals. At the time of the acquisition, Healthy Pet had estimated annualized revenue of approximately \$80.0 million. This acquisition allowed us to expand our animal hospital operations, particularly in Massachusetts, Connecticut, Virginia and Georgia. Our consolidated financial

statements reflect the operating results of Healthy Pet since June 1, 2007.

The total purchase price for this acquisition was \$185.0 million, consisting of: \$153.7 million in cash paid to holders of Healthy Pet's stock and debt; \$17.7 million in assumed debt; \$12.3 million in assumed liabilities; and \$1.3 million paid for professional and other outside services.

In addition, we incurred integration costs of \$1.6 million in 2007, primarily to operate Healthy Pet's corporate office, which was closed in November 2007. These costs were expensed as incurred and are included in corporate selling, general and administrative expense.



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### ***Acquisition of Pet s Choice***

On July 1, 2005, we acquired Pet s Choice, which operated 46 animal hospitals as of the acquisition date. This acquisition allowed us to expand our animal hospital operations, particularly in Texas and Washington. At the time of the acquisition, Pet s Choice had estimated annualized revenue of approximately \$70.0 million. Our consolidated financial statements include the operating results of Pet s Choice since July 1, 2005.

The total purchase price for this acquisition was \$78.8 million, consisting of: \$51.1 million in cash paid to holders of Pet s Choice stock and debt; \$14.1 million in assumed debt; \$12.8 million in assumed liabilities; and \$833,000 paid for professional and other outside services.

In addition, we incurred integration costs of \$1.2 million in 2005 primarily to operate Pet s Choice s corporate office, which was closed in October 2005. These costs were expensed as incurred and are included in corporate selling, general and administrative expense.

### **Critical Accounting Policies**

We believe that the application of the following accounting policies, which are important to our financial position and results of operations, require significant judgments and estimates on the part of management. For a summary of all our accounting policies, including the accounting policies discussed below, see Note 2., *Summary of Significant Accounting Policies*, in our consolidated financial statements of this 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 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, 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.

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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 may be 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 the price for those products and services when sold separately by us or the contractual renewal rates for the post-contract customer support services that we provide. 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 VSOE of 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: i) on a straight-line basis over the life of the post-contract service period if this is the only undelivered element, or ii) when the last undelivered element is delivered. Each transaction requires careful analysis to determine whether all of the individual elements in the license transaction have been identified, along with the fair value of 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.

For those sales arrangements where we have determined VSOE of fair value for all undelivered elements, we allocate revenue to the undelivered items based on the VSOE of value independent of any discounts given. We then recognize the revenue for undelivered elements when elements are delivered. We recognize the remaining or 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 post-contract customer support ( 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.

In the third quarter of 2005, we established VSOE of fair value for the undelivered elements for a majority of our sales arrangements by including renewal rates in the sales contracts for PCS. As a result, for transactions with defined

renewal rates for PCS, we began recognizing revenue on the sale of our digital radiography imaging equipment, computer hardware and software at the time of delivery or installation and customer acceptance if required per the sale arrangement, and revenue from the PCS on a straight-line basis over the term of the support period. Prior to the third quarter of 2005, we recognized revenue on all elements in these sales arrangements ratably over the period of the PCS.

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### *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 separating the transaction into individual 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 we 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.

### *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.

### *Valuation of Goodwill and Other Intangible Assets*

#### *Goodwill*

We allocate a significant portion of the purchase price for our acquired businesses to goodwill. Our 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 total amount of our goodwill at December 31, 2007 was \$822.0 million, consisting of \$95.3 million for our laboratory segment, \$707.5 million for our animal hospital segment and \$19.2 million for our medical technology segment.

We test our goodwill for impairment annually, or sooner if circumstances indicate an impairment may exist, in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 142, *Goodwill and Other Intangible Assets* ( SFAS No. 142 ). When SFAS No. 142 was issued in 2001, we adopted the end of December as our annual impairment testing date. During the current year, we elected to change our date to the end of October. An October 31st testing date allowed us additional time to accurately complete our impairment testing process in order to incorporate the results in our annual financial statements and timely file those statements with the Securities Exchange Commission in accordance with our accelerated filing requirements. There were no impairment charges resulting from either the October 31, 2007 or December 31, 2006 impairment tests. In addition, no events have occurred subsequent to the 2007 testing date which would indicate any impairment may have occurred.

The recognition and measurement of a goodwill impairment loss involves a two-step process:

First we identify potential impairment by comparing the estimated fair value of our reporting units with the carrying value of our reporting units per our accounting books, with carrying value defined as the reporting unit's net assets, including goodwill, less liabilities. If the estimated fair value of our reporting units is greater than our carrying value, there is no impairment and the second step is not needed.

We use independent valuation experts to advise and assist us in determining the estimated fair value of our reporting units. Our estimated fair values are based on generally accepted valuation techniques consisting

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primarily of market comparables and discounted cash flow techniques. These valuation methods involve the use of significant assumptions and estimates.

If we identify a potential impairment in the first step, we are then required to measure the amount of impairment. The amount of the impairment is determined by allocating the estimated fair value of the reporting unit as determined in step one to the reporting unit's net assets based on fair value as would be done in an acquisition. In this hypothetical acquisition, the residual estimated fair value after allocation to the reporting unit's identifiable net assets is the estimated fair value of goodwill. If the estimated fair value of goodwill is less than the carrying amount of goodwill, goodwill is considered impaired and written down to the estimated fair value with a corresponding charge to earnings. However, if the estimated fair value of goodwill is greater than the carrying amount of goodwill, goodwill is not considered impaired and is not adjusted to the estimated fair value.

Determining the fair value of the net assets of our reporting units under this step would require significant estimates.

In 2007, 2006 and 2005, we determined at the end of our annual review that the estimated fair value of each of our reporting units exceeded their respective net book value, resulting in a conclusion that none of our goodwill for our reporting units was impaired. However, changes in our estimates, such as forecasted cash flows, would have affected the estimated fair value of our reporting units and could have resulted in a goodwill impairment charge particularly for our medical technology reporting unit as the fair value of our laboratory and animal hospital reporting units significantly exceeded their respective book value.

### *Other Intangible Assets*

In addition to goodwill, we acquire other identifiable intangible assets in our acquisitions, including but not limited to covenants-not-to-compete, client lists, lease related assets and customer relationships. We value these identifiable intangible assets at estimated fair value. We use independent valuation experts to advise and assist us in determining what identifiable intangible assets we have acquired in an acquisition as well as how to estimate the fair value of those assets. Our estimated fair values are based on generally accepted valuation techniques such as market comparables, discounted cash flow techniques or costs to replace. These valuation methods involve the use of significant assumptions such as the timing and amount of future cash flows, risks, appropriate discount rates, and the useful lives of intangible assets.

Subsequent to acquisition, we test our identifiable intangible assets for impairment as part of a broader test for impairment of long-lived assets under SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* ( SFAS No. 144 ), whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The recognition and measurement of an impairment loss under SFAS No. 144 also involves a two-step process:

First we identify potential impairment by estimating the aggregate projected undiscounted future cash flows associated with an asset or asset pool and compare that amount with the carrying value of those assets. If the aggregate projected cash flow is greater than our carrying amount, there is no impairment and the second step is not needed.

When we test for impairment, the cash flows that are used contain our best estimates, which include appropriate and customary assumptions.

If we identify a potential impairment in the first step, we are then required to write the assets down to fair value with a corresponding charge to earnings. If the fair value is greater than carrying value, there is no adjustment. We may be required to make significant estimates in determining the fair value of some of our assets.

***Income Taxes***

We account for income taxes under SFAS No. 109, *Accounting for Income Taxes* ( SFAS No. 109 ). In accordance with SFAS No. 109, we record deferred tax liabilities and deferred tax assets, which represent taxes to be settled or recovered in the future. We adjust our deferred tax assets and deferred tax liabilities to



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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.

We make judgments in assessing our ability to realize future benefits from our deferred tax assets, which include operating and capital loss carryforwards. We believe that our earnings during the periods when the temporary differences become deductible will be sufficient to realize the related future tax benefits. Should we determine that we would not be able to realize all or a portion of our deferred tax assets, an adjustment would be made to the carrying amount through a valuation allowance.

Also, our net deductible temporary differences and tax carryforwards are recorded using the enacted tax rates expected to apply to taxable income in the periods in which the deferred tax liability or asset is expected to be settled or realized. At December 31, 2007, we have a net deferred tax liability of \$13.8 million. Should the expected applicable tax rates change in the future, an adjustment to the net deferred tax liability would be credited or charged, as appropriate, to income in the period such determination was made. For example, an increase of 1.0% in our anticipated income tax rate would cause us to increase our net deferred tax liability balance by \$336,000 with a corresponding charge to earnings.

We also assess differences between our tax bases, which are more likely than not to be realized, and the as-filed tax bases of certain assets and liabilities. At December 31, 2005, we had contingent liabilities of \$6.8 million recorded in other liabilities in our consolidated balance sheet related to such differences. During the first quarter of 2006, we determined that these contingencies no longer existed due to the outcome of an income tax audit and recognized a tax benefit of \$6.8 million.

Effective January 1, 2007, we adopted the provisions of 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 on either the effective date of the pronouncement or December 31, 2007.

### ***Self-Insured Liabilities***

We self-insure and use high retention or high deductible insurance programs for certain losses related to workers compensation and employee health claims. Our self insured liabilities contain uncertainties because we are required to make assumptions and to apply judgment to estimate the ultimate cost to settle reported claims and claims incurred but not reported as of the balance sheet date. We have not made any material changes in the accounting methodology used to establish our self-insured liabilities during the past three years.

#### ***Workers Compensation Insurance***

A majority of our workers compensation insurance policies are self-insured retention annual policies that begin on October 1. The policies cover specific annual periods and are normally open for no longer than seven years after the period allowing claims for incidents occurring during the covered period to be submitted after the end of the policy year.

Under our workers compensation insurance policies, we are responsible for the first \$250,000 in claim liability per individual occurrence and we are also subject to an aggregate limit. We use both an internal review process and an independent third-party actuarial review to estimate claim liability based on actual and expected claims incurred and the estimated ultimate cost to settle the claims. Periodically, we review our assumptions and the valuations provided by independent third-party actuaries to determine the adequacy of our self-insured liabilities. During the fourth quarter

of 2007, based upon information received from our actuaries, combined with our own internal review, we revised our estimate of our claims liability resulting in a \$2.2 million favorable impact to our net earnings for the period.

**Table of Contents***Health Insurance*

With the exception of California employees enrolled in HMO plans, we are effectively self-insuring our employee health care benefit by retaining claims liability risk up to \$150,000 per incident and an aggregate claim limit based on the number of employees enrolled in the plan per month. We estimate our liability for the uninsured portion of employee health care obligations that have been incurred but not reported based on our claims experience, the number of employees enrolled in the program and the average time from when a claim is incurred to the time it is paid. In addition, we retain an independent third-party actuary to provide an analysis of potential liability for open claims.

**Consolidated Results of Operations**

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

	<b>For The Years Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Revenue:			
Laboratory	25.6%	26.3%	26.4%
Animal hospital	73.0	72.4	72.4
Medical technology	4.0	4.0	3.6
Intercompany	(2.6)	(2.7)	(2.4)
Total revenue	100.0	100.0	100.0
Direct costs	72.2	72.5	73.1
Gross profit	27.8	27.5	26.9
Selling, general and administrative expense	7.5	7.9	7.9
Write-down and loss on sale of assets	0.1		
Operating income	20.2	19.6	19.0
Interest expense, net	2.6	2.5	3.0
Debt retirement costs			2.3
Minority interest in income of subsidiaries	0.3	0.3	0.4
Income before provision for income taxes	17.3	16.8	13.3
Provision for income taxes	6.8	6.1	5.2
Net income	10.5%	10.7%	8.1%

*Revenue*

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

	<b>For The Years Ended December 31,</b>			
	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>% Change</b>

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	\$	% of Total	\$	% of Total	\$	% of Total	2007	2006
Laboratory	\$ 295,695	25.6%	\$ 258,345	26.3%	\$ 222,064	26.4%	14.5%	16.3%
Animal hospital	844,344	73.0%	711,997	72.4%	607,565	72.4%	18.6%	17.2%
Medical technology	46,823	4.0%	39,305	4.0%	30,330	3.6%	19.1%	29.6%
Intercompany	(30,717)	(2.6)%	(26,334)	(2.7)%	(20,293)	(2.4)%	16.6%	29.8%
Total revenue	\$ 1,156,145	100.0%	\$ 983,313	100.0%	\$ 839,666	100.0%	17.6%	17.1%

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Consolidated revenue increased \$172.8 million in 2007 as compared to 2006, and \$143.6 million in 2006 as compared to 2005. The increases in revenue were attributable to the combination of revenue from acquired animal hospitals, including Healthy Pet acquired on June 1, 2007 and Pet's Choice acquired on July 1, 2005, and organic growth. Our laboratory internal revenue growth, adjusted for differences in billing days, was 13.5% and 15.2%, in 2007 and 2006, respectively. Our animal hospital same-store revenue growth, adjusted for differences in business days, was 5.2% and 5.8% in 2007 and 2006, respectively.

Historically, the animal healthcare industry and our business have been relatively resistant to changes in the general economy. Our fourth quarter results appear to indicate that we were marginally impacted by the uncertainty in the economy. During this quarter, our laboratory internal revenue growth, adjusted for differences in billing days, was 9.1% and our animal hospital same-store revenue growth, adjusted for differences in business days, was 2.5%.

***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):

	<b>For The Years Ended December 31,</b>							
	<b>2007</b>		<b>2006</b>		<b>2005</b>		<b>% Change</b>	
	<b>\$</b>	<b>Gross Margin</b>	<b>\$</b>	<b>Gross Margin</b>	<b>\$</b>	<b>Gross Margin</b>	<b>2007</b>	<b>2006</b>
Laboratory	\$ 143,072	48.4%	\$ 119,449	46.2%	\$ 98,926	44.5%	19.8%	20.7%
Animal hospital	163,053	19.3%	138,358	19.4%	118,239	19.5%	17.8%	17.0%
Medical technology	15,879	33.9%	14,213	36.2%	9,433	31.1%	11.7%	50.7%
Intercompany	(583)	(1.9)%	(1,456)	(5.5)%	(731)	(3.6)%	(60.0)%	99.2%
Total gross profit	\$ 321,421	27.8%	\$ 270,564	27.5%	\$ 225,867	26.9%	18.8%	19.8%

Consolidated gross profit increased \$50.9 million in 2007 as compared to 2006, and \$44.7 million in 2006 as compared to 2005. The increases in both periods were primarily due to the increase in consolidated revenue discussed above and improvements in consolidated gross margins as compared to the previous year. The improvement in our consolidated gross margin in 2007 as compared to 2006 was primarily attributable to an increase in our laboratory gross margin, partially offset by a decrease in our animal hospital and medical technology gross margins. Consolidated gross margins in 2007 also benefited from a decrease in workers' compensation insurance expense of \$3.2 million, or 0.3% of revenue, due to a reduction in our estimated workers' compensation insurance liability for policy periods prior to 2007. An increase in animal hospital revenue, which had a lower gross margin than our other operating segments, as a percentage of our total consolidated revenue had a partially offsetting impact to our consolidated gross margin. The improvement in our consolidated gross margin in 2006 as compared to 2005 was primarily attributable to an increase in our laboratory and medical technology gross margins, partially offset by a decrease in our animal hospital gross margin.

**Table of Contents*****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):

	For The Years Ended December 31,							
	2007		2006		2005		% Change	
	\$	% of Revenue	\$	% of Revenue	\$	% of Revenue	2007	2006
Laboratory	\$ 19,648	6.6%	\$ 17,460	6.8%	\$ 13,993	6.3%	12.5%	24.8%
Animal hospital	21,562	2.6%	20,232	2.8%	16,224	2.7%	6.6%	24.7%
Medical technology	11,528	24.6%	10,762	27.4%	9,033	29.8%	7.1%	19.1%
Corporate	34,139	3.0%	29,566	3.0%	26,935	3.2%	15.5%	9.8%
Total SG&A	\$ 86,877	7.5%	\$ 78,020	7.9%	\$ 66,185	7.9%	11.4%	17.9%

Consolidated selling, general and administrative expense increased \$8.9 million in 2007 as compared to 2006 primarily due to growth in the size of our company as a result of acquisitions. Our selling, general and administrative expense as a percentage of revenue declined due to the aforementioned increase in revenue combined with leverage. In addition to normal increases in selling, general and administrative expense to support the growth of our company, we incurred \$1.6 million, or 0.1% of consolidated revenue in 2007, for integration costs in connection with operating Healthy Pet's corporate office, which was closed in November 2007. These integration costs are included in corporate selling, general and administrative expense.

Consolidated selling, general and administrative expense increased \$11.8 million in 2006 as compared to 2005 primarily due to an increase in the size of our company. In addition to normal increases in selling, general and administrative expense to support the growth of our company, we recognized \$2.4 million, or 0.2% of consolidated revenue in 2006, for share-based compensation as a result of adopting SFAS No. 123 (revised 2004), *Share-Based Payment*, on January 1, 2006. In addition, in 2005, we recognized \$1.2 million, or 0.1% of consolidated revenue, for integration costs primarily to operate Pet's Choice's corporate office, which was closed in October 2005. These integration costs are included in Corporate selling, general and administrative expense.

***Write-down and Loss on Sale of Assets***

In 2007, 2006 and 2005, we sold assets, including real estate, and wrote down certain assets, for net losses of \$1.3 million, \$17,000 and \$441,000, respectively.

***Operating Income***

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

	For The Years Ended December 31,							
	2007		2006		2005		% Change	
	\$	% of Revenue	\$	% of Revenue	\$	% of Revenue	2007	2006

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Laboratory	\$ 123,344	41.7%	\$ 101,981	39.5%	\$ 84,928	38.2%	20.9%	20.1%
Animal hospital	140,344	16.6%	118,138	16.6%	101,581	16.7%	18.8%	16.3%
Medical technology	4,256	9.1%	3,451	8.8%	400	1.3%	23.3%	762.8%
Corporate	(34,140)	(3.0)%	(29,587)	(3.0)%	(26,937)	(3.2)%	15.4%	9.8%
Eliminations	(583)	(1.9)%	(1,456)	(5.5)%	(731)	(3.6)%	(60.0)%	99.2%
Total operating income	\$ 233,221	20.2%	\$ 192,527	19.6%	\$ 159,241	19.0%	21.1%	20.9%

The increase in our operating margin over the past three years was primarily due to both increasing revenues and our ability to leverage our existing cost structure as discussed above under gross profit.

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

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

	<b>For The Years Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Interest expense:			
Senior term notes	\$ 31,915	\$ 26,078	\$ 18,746
9.875% senior subordinated notes			6,342
Interest rate swap agreements	(1,536)	(1,542)	57
Capital leases and other	2,158	1,414	1,385
Amortization of debt costs	368	361	547
	32,905	26,311	27,077
Interest income	3,402	2,071	2,034
Total interest expense, net of interest income	\$ 29,503	\$ 24,240	\$ 25,043

The increase in interest expense in 2007 as compared to 2006 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.

The decrease in interest expense in 2006 as compared to 2005 was primarily attributable to our debt refinancing transaction, which is discussed below in the *Liquidity and Capital Resources* section, and changes in LIBOR.

***Debt Retirement Costs***

In connection with a debt refinancing transaction, we incurred debt retirement costs of \$19.3 million in 2005, which is discussed below in the *Liquidity and Capital Resources* section.

***Other (Income) Expense***

Other (income) expense relates primarily to non-cash gains or losses pertaining to the changes in the time value of our interest rate swap agreements.

***Minority Interest in Income of Subsidiaries***

Minority interest in income of subsidiaries represents our partners' proportionate share of income generated by those subsidiaries that we do not wholly own.

***Provision for Income Taxes***

Our effective tax rate was 39.4%, 36.1% and 39.4% in 2007, 2006 and 2005, respectively. The effective tax rate for 2006 reflects 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 in our estimated tax liabilities.





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

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

	For The Years Ended December 31,						% Change	
	2007		2006		2005		2007	2006
	\$	Gross Margin	\$	Gross Margin	\$	Gross Margin		
Revenue	\$ 295,695		\$ 258,345		\$ 222,064		14.5%	16.3%
Gross profit	\$ 143,072	48.4%	\$ 119,449	46.2%	\$ 98,926	44.5%	19.8%	20.7%

Laboratory revenue increased \$37.4 million in 2007 as compared to 2006, and \$36.3 million in 2006 as compared to 2005. The components of the increase in laboratory revenue are detailed below (in thousands, except percentages and average price per requisition):

	2007 Comparative Analysis			2006 Comparative Analysis		
	For The Years Ended December 31,			For The Years Ended December 31,		
	2007	2006	% Change	2006	2005	% Change
<b>Laboratory Revenue:</b>						
Internal growth:						
Number of requisitions(1)	12,448	11,061	12.5%	10,993	9,453	16.3%
Average revenue per requisition(2)	\$ 23.48	\$ 23.28	0.9%	\$ 23.27	\$ 23.49	(0.9)%
Total internal revenue(1)	\$ 292,249	\$ 257,522	13.5%	\$ 255,767	\$ 222,064	15.2%
Billing day adjustment(3)		823				
Acquired revenue(4)	3,446			2,578		
Total	\$ 295,695	\$ 258,345	14.5%	\$ 258,345	\$ 222,064	16.3%

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

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

(3) The 2006 billing day adjustment in the 2007 Comparative Analysis reflects the impact of one additional billing day in 2006 as compared to 2007.

- (4) Acquired revenue in both the 2007 and 2006 Comparative Analyses represents the revenue of the laboratories acquired in each of those respective years.

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 year-over-year increase in the number of requisitions was testing related to the pet food recall that occurred in March and April of 2007.

We derive our laboratory revenue from services provided to over 16,000 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

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hospitals, however, and shifts in the purchasing habits of these networks have the potential of a greater impact on our laboratory revenues.

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

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

The increase in laboratory gross margins were 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 Segment*

The following table summarizes revenue and gross profit for the animal hospital segment (in thousands, except percentages):

	For The Years Ended December 31,						
	2007		2006		2005		% Change
	\$	Gross Margin	\$	Gross Margin	\$	Gross Margin	
Revenue	\$ 844,344		\$ 711,997		\$ 607,565		18.6%
Gross profit	\$ 163,053	19.3%	\$ 138,358	19.4%	\$ 118,239	19.5%	17.8%
							17.0%

Animal hospital revenue increased \$132.3 million in 2007 as compared to 2006, and \$104.4 million in 2006 as compared to 2005. The components of the increases are summarized in the following table (in thousands, except percentages and average price per order):

	2007 Comparative Analysis			2006 Comparative Analysis		
	For The Years Ended December 31,			For The Years Ended December 31,		
	2007	2006	% Change	2006	2005	% Change
<b>Animal Hospital Revenue:</b>						
Same-store facility:						
Orders(1)(2)	5,138	5,164	(0.5)%	4,391	4,457	(1.5)%
Average revenue per order(3)	\$ 139.80	\$ 132.26	5.7%	\$ 130.17	\$ 121.20	7.4%
Same-store revenue(1)	\$ 718,224	\$ 683,012	5.2%	\$ 571,577	\$ 540,209	5.8%

Business day adjustment(4)					1,454	
Net acquired revenue(5)	126,120	28,985		140,420	65,902	
Total	\$ 844,344	\$ 711,997	18.6%	\$ 711,997	\$ 607,565	17.2%

(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.

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- (3) Computed by dividing same-store revenue by same-store orders. The average revenue per order may not calculate exactly due to rounding.
- (4) The 2005 business day adjustment reflects the impact of one additional business day in 2005 as compared to 2006.
- (5) Net acquired revenue represents the revenue from those animal hospitals acquired, net of revenue from those animal hospitals sold or closed, on or after the beginning of the comparable period, which was January 1, 2006 for the 2007 Comparative Analysis and January 1, 2005 for the 2006 Comparative 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 continues to emphasize comprehensive wellness visits and advanced medical procedures, which typically generate higher-priced orders.

Price increases, which approximated 5% to 6% on most services at most 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. Over the last few years, we have experienced a decline in animal hospital revenue from the sale of pet-related products, which we believe are now widely available in retail stores and other distribution channels.

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

Over the last several years we have acquired a significant number of animal hospitals. Many of these newly acquired animal hospitals had lower gross margins at the time of acquisition than those previously operated by us. Historically, these lower gross margins, in the aggregate, have been favorably impacted subsequent to the acquisition by improvements in animal hospital revenue, increased operating leverage and our integration efforts. However, due to the substantial amount of acquisition activity that has occurred in a relatively short period of time, our gross margins have declined. Our animal hospital gross margin in 2007, 2006 and 2005 was 19.3% to 19.4% and 19.5%, respectively.

Our animal hospital same-store gross margin improved to 19.8% in 2007 as compared to 19.6% in 2006. In 2007, our same-store animal hospitals benefited from a \$2.6 million, or 0.3% of same-store revenue, decrease in our estimated workers' compensation insurance liability recognized during the fourth quarter of 2007. Excluding the impact related to the workers' compensation insurance benefit, our same-store gross margin declined in 2007 as compared to 2006 primarily as a result of an increase in labor and health insurance costs. Our animal hospital same-store gross margin in 2006 and 2005 was 20.1%.

### *Medical Technology Segment*

The following table summarizes revenue and gross profit for the medical technology segment (in thousands, except percentages):