

VCA ANTECH INC
Form 10-Q
August 09, 2012

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

FORM 10-Q

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

For the quarterly period ended June 30, 2012

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 90064-1022
(Address of principal executive offices)
(310) 571-6500
(Registrant's telephone number, including area code)

95-4097995
(I.R.S. Employer
Identification No.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No .
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No .

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: common stock, \$0.001 par value, 87,760,371 shares as of August 3, 2012.

VCA Antech, Inc. and Subsidiaries
Form 10-Q
June 30, 2012

Table of Contents

| | Page Number |
|---|----------------|
| <u>Part I. Financial Information</u> | |
| <u>Item 1. Financial Statements (Unaudited)</u> | |
| <u>Condensed, Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011</u> | <u>1</u> |
| <u>Condensed, Consolidated Income Statements for the Three and Six Months Ended June 30, 2012 and 2011</u> | <u>2</u> |
| <u>Condensed, Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2012 and 2011</u> | <u>3</u> |
| <u>Condensed, Consolidated Statements of Equity for the Six Months Ended June 30, 2012 and 2011</u> | <u>4</u> |
| <u>Condensed, Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2012 and 2011</u> | <u>5</u> |
| <u>Notes to Condensed, Consolidated Financial Statements</u> | <u>7</u> |
| <u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>20</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | <u>34</u> |
| <u>Item 4. Controls and Procedures</u> | <u>35</u> |
| <u>Part II. Other Information</u> | |
| <u>Item 1. Legal Proceedings</u> | <u>36</u> |
| <u>Item 1A. Risk Factors</u> | <u>36</u> |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>36</u> |
| <u>Item 3. Defaults Upon Senior Securities</u> | <u>36</u> |
| <u>Item 4. Mine Safety Disclosures</u> | <u>36</u> |
| <u>Item 5. Other Information</u> | <u>36</u> |
| <u>Item 6. Exhibits</u> | <u>36</u> |
| <u>Signature</u> | <u>37</u> |
| <u>Exhibit Index</u> | <u>38</u> |

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

| | June 30, 2012 | December 31, 2011 |
|--|---------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$64,067 | \$63,651 |
| Trade accounts receivable, less allowance for uncollectible accounts of \$15,599 and \$14,978 at June 30, 2012 and December 31, 2011, respectively | 65,299 | 58,279 |
| Inventory | 54,282 | 48,661 |
| Prepaid expenses and other | 23,923 | 21,883 |
| Deferred income taxes | 27,671 | 26,310 |
| Prepaid income taxes | 21,310 | 18,373 |
| Total current assets | 256,552 | 237,157 |
| Property and equipment, net | 384,704 | 370,646 |
| Goodwill | 1,345,529 | 1,237,607 |
| Other intangible assets, net | 107,927 | 92,403 |
| Notes receivable, net | 6,232 | 6,202 |
| Deferred financing costs, net | 4,868 | 5,435 |
| Other | 45,383 | 45,918 |
| Total assets | \$2,151,195 | \$1,995,368 |
| Liabilities and Equity | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$34,974 | \$32,571 |
| Accounts payable | 34,798 | 37,797 |
| Accrued payroll and related liabilities | 46,857 | 42,658 |
| Other accrued liabilities | 56,270 | 43,968 |
| Total current liabilities | 172,899 | 156,994 |
| Long-term debt, less current portion | 613,181 | 586,282 |
| Deferred income taxes | 116,945 | 101,229 |
| Other liabilities | 35,574 | 25,947 |
| Total liabilities | 938,599 | 870,452 |
| Commitments and contingencies | | |
| Redeemable noncontrolling interests | 6,985 | 6,964 |
| Preferred stock, par value \$0.001, 11,000 shares authorized, none outstanding | — | — |
| VCA Antech, Inc. stockholders' equity: | | |
| Common stock, par value \$0.001, 175,000 shares authorized, 87,741 and 86,796 shares outstanding as of June 30, 2012 and December 31, 2011, respectively | 88 | 87 |
| Additional paid-in capital | 379,624 | 361,715 |
| Retained earnings | 815,223 | 745,658 |
| Accumulated other comprehensive income | 5 | 418 |
| Total VCA Antech, Inc. stockholders' equity | 1,194,940 | 1,107,878 |
| Noncontrolling interests | 10,671 | 10,074 |
| Total equity | 1,205,611 | 1,117,952 |

| | | |
|------------------------------|-------------|-------------|
| Total liabilities and equity | \$2,151,195 | \$1,995,368 |
|------------------------------|-------------|-------------|

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

1

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

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------|------------------|-----------|
| | June 30, | | June 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| Revenue | \$438,372 | \$376,105 | \$847,837 | \$731,228 |
| Direct costs | 337,765 | 279,273 | 653,851 | 554,618 |
| Gross profit | 100,607 | 96,832 | 193,986 | 176,610 |
| Selling, general and administrative expense | 38,997 | 26,663 | 78,048 | 52,846 |
| Net loss on sale of assets | 112 | 60 | 635 | 149 |
| Operating income | 61,498 | 70,109 | 115,303 | 123,615 |
| Interest expense, net | 4,364 | 4,575 | 8,451 | 8,594 |
| Business combination adjustment gain | — | — | (5,719) | — |
| Other income | (148) | (67) | (355) | (9) |
| Income before provision for income taxes | 57,282 | 65,601 | 112,926 | 115,030 |
| Provision for income taxes | 21,504 | 25,536 | 40,827 | 44,469 |
| Net income | 35,778 | 40,065 | 72,099 | 70,561 |
| Net income attributable to noncontrolling interests | 1,458 | 453 | 2,534 | 2,110 |
| Net income attributable to VCA Antech, Inc | \$34,320 | \$39,612 | \$69,565 | \$68,451 |
| Basic earnings per share | \$0.39 | \$0.46 | \$0.80 | \$0.79 |
| Diluted earnings per share | \$0.39 | \$0.45 | \$0.79 | \$0.78 |
| Weighted-average shares outstanding for basic earnings per share | 87,589 | 86,535 | 87,443 | 86,445 |
| Weighted-average shares outstanding for diluted earnings per share | 88,723 | 87,304 | 88,555 | 87,303 |

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

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Net income ⁽¹⁾ | \$35,778 | \$40,065 | \$72,099 | \$70,561 |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustments | (1,369) | 47 | (442) | 296 |
| Unrealized (loss) gain on foreign currency | (178) | 48 | 47 | 237 |
| Tax benefit (expense) | 70 | (19) | (18) | (92) |
| Other comprehensive (loss) gain | (1,477) | 76 | (413) | 441 |
| Total comprehensive income | 34,301 | 40,141 | 71,686 | 71,002 |
| Comprehensive income attributable to noncontrolling interests ⁽¹⁾ | (1,458) | (453) | (2,534) | (2,110) |
| Comprehensive income attributable to VCA Antech, Inc | \$32,843 | \$39,688 | \$69,152 | \$68,892 |

⁽¹⁾ Includes approximately \$1.3 million and \$1.1 million of net income related to redeemable and mandatorily redeemable noncontrolling interests for the six months ended June 30, 2012 and June 30, 2011, respectively.

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

3

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

| | Common Stock | | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income | Noncontrolling Interests | Total |
|--|--------------|--------|----------------------------------|----------------------|---|-----------------------------|-------------|
| | Shares | Amount | | | | | |
| Balances, December 31, 2010 | 86,179 | \$ 86 | \$347,848 | \$650,253 | \$ 737 | \$ 10,561 | \$1,009,485 |
| Net income (excludes \$830 and \$227 related to redeemable and mandatorily redeemable noncontrolling interests, respectively) | — | — | — | 68,451 | — | 1,053 | 69,504 |
| Other comprehensive income | — | — | — | — | 441 | — | 441 |
| Distribution to noncontrolling interests | — | — | — | — | — | (607) | (607) |
| Purchase of noncontrolling interests | — | — | 263 | — | — | (874) | (611) |
| Share-based compensation | — | — | 2,531 | — | — | — | 2,531 |
| Issuance of common stock under stock incentive plans | 416 | 1 | 2,455 | — | — | — | 2,456 |
| Stock repurchases | — | — | (2,337) | — | — | — | (2,337) |
| Excess tax benefit from stock options | — | — | 906 | — | — | — | 906 |
| Tax shortfall and other from stock options and awards | — | — | (460) | — | — | — | (460) |
| Balances, June 30, 2011 | 86,595 | \$ 87 | \$351,206 | \$718,704 | \$ 1,178 | \$ 10,133 | \$1,081,308 |
| Balances, December 31, 2011 | 86,796 | \$ 87 | \$361,715 | \$745,658 | \$ 418 | \$ 10,074 | \$1,117,952 |
| Net income (excludes \$463 and \$839 related to redeemable and mandatorily redeemable noncontrolling interests, respectively). | — | — | — | 69,565 | — | 1,232 | 70,797 |
| Other comprehensive loss | — | — | — | — | (413) | — | (413) |
| Distribution to noncontrolling interests | — | — | — | — | — | (635) | (635) |
| Share-based compensation | — | — | 7,767 | — | — | — | 7,767 |
| Issuance of common stock under stock incentive plans | 472 | 1 | 2,190 | — | — | — | 2,191 |
| Issuance of common stock for acquisitions | 473 | — | 10,500 | — | — | — | 10,500 |
| Stock repurchases | — | — | (2,805) | — | — | — | (2,805) |
| Excess tax benefit from stock options | — | — | 248 | — | — | — | 248 |
| Tax benefit and other from stock options and awards | — | — | 9 | — | — | — | 9 |

Edgar Filing: VCA ANTECH INC - Form 10-Q

| | | | | | | | |
|-------------------------|--------|-------|-----------|-----------|------|-----------|-------------|
| Balances, June 30, 2012 | 87,741 | \$ 88 | \$379,624 | \$815,223 | \$ 5 | \$ 10,671 | \$1,205,611 |
|-------------------------|--------|-------|-----------|-----------|------|-----------|-------------|

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

4

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

| | Six Months Ended | |
|---|------------------|------------|
| | June 30, | |
| | 2012 | 2011 |
| Cash flows from operating activities: | | |
| Net income | \$72,099 | \$70,561 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 37,363 | 26,456 |
| Amortization of debt issue costs | 642 | 774 |
| Provision for uncollectible accounts | 2,551 | 2,492 |
| Business combination adjustment gain | (5,719) |) |
| Net loss on sale of assets | 635 | 149 |
| Share-based compensation | 7,767 | 2,531 |
| Deferred income taxes | 10,020 | 10,833 |
| Excess tax benefit from exercise of stock options | (248) |) (906) |
| Other | (528) |) (202) |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | (6,900) |) (7,813) |
| Inventory, prepaid expense and other assets | (5,795) |) (5,222) |
| Accounts payable and other accrued liabilities | (1,805) |) (7,994) |
| Accrued payroll and related liabilities | 1,102 | 16,021 |
| Income taxes | (2,516) |) 7,940 |
| Net cash provided by operating activities | 108,668 | 115,620 |
| Cash flows from investing activities: | | |
| Business acquisitions, net of cash acquired | (75,828) |) (11,804) |
| Real estate acquired in connection with business acquisitions | — |) (1,900) |
| Property and equipment additions | (37,165) |) (28,434) |
| Proceeds from sale of assets | 78 | 140 |
| Other | 55 |) (493) |
| Net cash used in investing activities | (112,860) |) (42,491) |
| Cash flows from financing activities: | | |
| Repayment of debt | (43,318) |) (14,164) |
| Proceeds from issuance of long-term debt | 50,000 | — |
| Proceeds from revolving credit facility | 50,000 | — |
| Repayment of revolving credit facility | (50,000) |) — |
| Payment of financing costs | (122) |) — |
| Distributions to noncontrolling interest partners | (1,631) |) (1,141) |
| Proceeds from issuance of common stock under stock option plans | 2,885 | 2,456 |
| Excess tax benefit from exercise of stock options | 248 | 906 |
| Stock repurchases | (2,770) |) (2,337) |
| Other | (656) |) (345) |
| Net cash provided by (used in) financing activities | 4,636 |) (14,625) |
| Effect of currency exchange rate changes on cash and cash equivalents | (28) |) 153 |
| Increase in cash and cash equivalents | 416 | 58,657 |
| Cash and cash equivalents at beginning of period | 63,651 | 97,126 |
| Cash and cash equivalents at end of period | \$64,067 | \$155,783 |

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

5

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

| | Six Months Ended | |
|--|------------------|------------|
| | June 30, | |
| | 2012 | 2011 |
| Supplemental disclosures of cash flow information: | | |
| Interest paid | \$7,788 | \$8,127 |
| Income taxes paid | \$32,685 | \$25,696 |
| Supplemental schedule of noncash investing and financing activities: | | |
| Detail of acquisitions: | | |
| Fair value of assets acquired | \$147,527 | \$11,889 |
| Fair value of pre-existing investment in AVC | (11,850) |) — |
| Noncontrolling interest | (8,161) |) — |
| Cash paid for acquisitions | (75,328) |) (11,445) |
| Cash paid to debt holders | (25,915) |) — |
| Issuance of common stock for acquisitions | (10,500) |) — |
| Holdbacks | (1,525) |) (500) |
| Liabilities assumed | \$14,248 |) \$(56) |

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

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements
June 30, 2012
(Unaudited)

1. Nature of Operations

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

Our animal hospitals offer a full range of general medical and surgical services for companion animals. Our animal hospitals treat diseases and injuries, provide pharmaceutical products and perform a variety of pet-wellness programs, including health examinations, diagnostic testing, vaccinations, spaying, neutering and dental care. At June 30, 2012, we operated 592 animal hospitals throughout 41 states and in Canada.

We operate a full-service veterinary diagnostic laboratory network serving all 50 states and certain areas in Canada. Our laboratory network provides sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. At June 30, 2012, we operated 54 laboratories of various sizes located strategically throughout the United States and Canada.

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

Our Vetstreet business provides online communications, professional education, marketing solutions and an ecommerce platform for independent animal hospitals. In addition, Vetstreet.com provides a robust selection of products, information and services to the pet-owning community.

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

2. Basis of Presentation

Our accompanying unaudited, condensed, consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) for interim financial information and in accordance with the rules and regulations of the United States Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements as permitted under applicable rules and regulations. In the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year ending December 31, 2012. For further information, refer to our consolidated financial statements and notes thereto included in our 2011 Annual Report on Form 10-K.

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

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

3. Goodwill and Other Intangible Assets

Goodwill

The following table presents the changes in the carrying amount of our goodwill for the six months ended June 30, 2012 (in thousands):

| | Animal Hospital | Laboratory | All Other | Total |
|--|--------------------|------------|-----------|-------------|
| Balance as of December 31, 2011 | \$1,035,401 | \$96,810 | \$105,396 | \$1,237,607 |
| Goodwill acquired | 102,819 | 8 | 10,569 | 113,396 |
| Other ⁽¹⁾ | (5,104 |) 2 | (372 |) (5,474 |
| Balance as of June 30, 2012 ⁽²⁾ | \$1,133,116 | \$96,820 | \$115,593 | \$1,345,529 |

⁽¹⁾ Other includes acquisition-price adjustments, which consist primarily of an adjustment related to capital leases, buy-outs and foreign currency translation adjustments.

⁽²⁾ Net of accumulated impairment losses of \$21.3 million recorded in 2011, all related to our medical technology business, included in "All Other" in the above table.

We had no impairment losses during the six months ended June 30, 2012.

Other Intangible Assets

Our amortizable intangible assets at June 30, 2012 and December 31, 2011 are as follows (in thousands):

| | As of June 30, 2012 | | | As of December 31, 2011 | | |
|---|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Noncontractual customer relationships | \$101,683 | \$(28,103 |) \$73,580 | \$82,891 | \$(21,147 |) \$61,744 |
| Covenants not-to-compete | 12,859 | (7,020 |) 5,839 | 13,035 | (8,067 |) 4,968 |
| Favorable lease assets | 7,163 | (3,568 |) 3,595 | 5,571 | (3,210 |) 2,361 |
| Trademarks | 7,898 | (1,995 |) 5,903 | 7,405 | (1,686 |) 5,719 |
| Contracts | 4,062 | (437 |) 3,625 | 3,500 | (185 |) 3,315 |
| Technology | 19,183 | (3,832 |) 15,351 | 16,589 | (2,342 |) 14,247 |
| Client lists | 84 | (50 |) 34 | 84 | (35 |) 49 |
| Total | \$152,932 | \$(45,005 |) \$107,927 | \$129,075 | \$(36,672 |) \$92,403 |

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

3. Goodwill and Other Intangible Assets, continued

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

| | Three Months Ended | | Six Months Ended | |
|--------------------------------|--------------------|---------|------------------|---------|
| | June 30, | | June 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| Aggregate amortization expense | \$5,342 | \$2,604 | \$10,218 | \$5,259 |

The estimated amortization expense related to intangible assets for the remainder of 2012 and each of the succeeding years thereafter, as of June 30, 2012, is as follows (in thousands):

| | |
|-------------------|-----------|
| Remainder of 2012 | \$10,748 |
| 2013 | 19,710 |
| 2014 | 17,298 |
| 2015 | 15,429 |
| 2016 | 12,201 |
| Thereafter | 32,541 |
| Total | \$107,927 |

4. Other Accrued Liabilities

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

| | June 30, 2012 | December 31, 2011 |
|-----------------------------|------------------|----------------------|
| Deferred revenue | \$10,807 | \$7,025 |
| Accrued health insurance | 5,746 | 5,553 |
| Deferred rent | 4,062 | 3,626 |
| Accrued consulting fees | 2,886 | 2,886 |
| Holdbacks and earnouts | 3,297 | 2,250 |
| Customer deposits | 3,258 | 2,281 |
| Accrued lab service rebates | 289 | 332 |
| Other | 25,925 | 20,015 |
| | \$56,270 | \$43,968 |

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

5. Long-Term Obligations

Senior Credit Facility

On January 25, 2012, we executed an amendment (the "first amendment") to our Amended and Restated Credit and Guaranty Agreement entered into as of August 16, 2011 (our "senior credit facility"). On January 24, 2012, we issued new term loans in the aggregate principal amount of \$50.0 million, which reduced the amount of uncommitted incremental facilities we could thereafter elect to request from \$100.0 million in the aggregate to \$50.0 million in the aggregate. The aforementioned amendment on January 25, 2012 replenished the aggregate principal amount of uncommitted incremental facilities by \$50.0 million to permit us to request up to an aggregate principal amount of \$100.0 million in uncommitted incremental facilities. The funds borrowed from the Incremental Facility were used to repay in full amounts borrowed to fund an additional investment in Associate Veterinary Clinics (1981) LTD ("AVC") on February 1, 2012. In connection with the first amendment we incurred \$122,300 in financing costs, of which approximately \$47,300 were recognized as part of income from continuing operations and \$75,000 were capitalized as deferred financing costs.

The following table summarizes our long-term obligations at June 30, 2012 and December 31, 2011 (in thousands):

| | June 30, 2012 | December 31, 2011 |
|--|------------------|----------------------|
| Revolver | \$— | \$— |
| Senior term notes at the adjusted Eurodollar rate + 1.75% (2.00% at June 30, 2012) | 608,203 | 573,984 |
| Other debt and capital lease obligations | 39,952 | 44,869 |
| Total debt obligations | 648,155 | 618,853 |
| Less - current portion | (34,974) | (32,571) |
| | \$613,181 | \$586,282 |

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

- the base rate (as defined below) plus the applicable margin. The applicable margin for a base rate loan is an amount equal to the applicable margin for Eurodollar rate (as defined below) minus 1.00%; or

the adjusted Eurodollar rate (as defined below), plus a margin of 1.75% (Level II, see table below) per annum until the date of delivery of the compliance certificate and the financial statements for the period ended June 30, 2012, at which time the applicable margin will be determined by reference to the leverage ratio in effect from time to time as set forth in the following table:

| Level | Leverage Ratio | Applicable Margin for Eurodollar Rate Loans | Applicable Revolving Commitment Fee % |
|-------|-----------------------------|--|--|
| I | ≥ 2.50:1.00 | 2.25% | 0.50% |
| II | < 2.50:1.00 and ≥ 1.75:1.00 | 1.75% | 0.375% |
| III | < 1.75:1.00 and ≥ 1.00:1.00 | 1.50% | 0.25% |
| IV | < 1.00:1.00 | 1.25% | 0.20% |

The base rate for the senior term notes is a rate per annum equal to the greatest of Wells Fargo Bank, N.A. ("Wells Fargo") prime rate in effect on such day, the Federal funds effective rate in effect on such day plus 0.5% and the adjusted Eurodollar rate for a one-month interest period commencing on such day plus 1.0%. The adjusted Eurodollar

rate is defined as the rate per annum obtained by dividing (1) the rate of interest offered to Wells Fargo on the London interbank market by (2) a percentage equal to 100% minus the stated maximum rate of all reserve requirements applicable to any member bank of the Federal Reserve System in respect of "Eurocurrency liabilities."

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

5. Long-Term Obligations, continued

Maturity and Principal Payments. The amended and restated senior term notes mature on August 19, 2016. Principal payments on the senior term notes are paid quarterly in the amount of \$7.9 million for the first five quarters beginning on September 30, 2012, quarterly payments of \$11.8 million for the two years following, and quarterly payments of \$15.8 million for the three quarters prior to maturity at which time the remaining balance is due. The following table sets forth the remaining scheduled principal payments for our senior term notes (in thousands):

| | |
|---------------------|-----------|
| 2012 ⁽¹⁾ | \$15,781 |
| 2013 | 35,508 |
| 2014 | 47,344 |
| 2015 | 51,289 |
| 2016 | 458,281 |
| Total | \$608,203 |

⁽¹⁾ Relates to the period from July 1, 2012 through December 31, 2012.

The revolving credit facility matures on August 19, 2016. Principal payments on the revolving credit facility are made at our discretion with the entire unpaid amount due at maturity.

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

6. Fair Value Measurements

Fair Value of Financial Instruments

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

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

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

Long-Term Debt. The fair value of debt at June 30, 2012 and December 31, 2011 is based upon the ask price quoted from an external source, which is considered a Level 2 input.

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

6. Fair Value Measurements, continued

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

| | As of June 30, 2012 | | As of December 31, 2011 | |
|------------------------------|---------------------|------------|-------------------------|------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Variable-rate long-term debt | \$608,203 | \$608,203 | \$573,984 | \$573,984 |

At June 30, 2012 and December 31, 2011, we did not have any material applicable nonrecurring measurements of nonfinancial assets and nonfinancial liabilities.

7. Share-Based Compensation

Stock Option Activity

A summary of our stock option activity for the six months ended June 30, 2012 is as follows (in thousands):

| | Stock Options | Weighted-Average Exercise Price |
|--|---------------|---------------------------------|
| Outstanding at December 31, 2011 | 3,776 | \$16.92 |
| Granted | — | \$— |
| Exercised | (188) |) \$15.35 |
| Canceled | (39) |) \$20.13 |
| Outstanding at June 30, 2012 | 3,549 | \$16.96 |
| Exercisable at June 30, 2012 | 2,655 | \$17.30 |
| Vested and expected to vest at June 30, 2012 | 3,509 | \$16.98 |

There were no stock options granted during the six months ended June 30, 2012. The aggregate intrinsic value of our stock options exercised during the three and six months ended June 30, 2012 was \$97,000 and \$1.2 million, respectively, and the actual tax benefit realized on options exercised during these periods was \$38,000 and \$488,000, respectively.

At June 30, 2012 there was \$3.5 million of total unrecognized compensation cost related to our stock options. This cost is expected to be recognized over a weighted-average period of 3.3 years.

The compensation cost that has been charged against income for stock options for the three months ended June 30, 2012 and 2011 was \$269,000 and \$347,000, respectively. The corresponding income tax benefit recognized was \$105,000 and \$136,000 for the three months ended June 30, 2012 and 2011, respectively.

The compensation cost that has been charged against income for stock options for the six months ended June 30, 2012 and 2011 was \$744,000 and \$694,000, respectively. The corresponding income tax benefit recognized was \$291,000 and \$271,000 for the six months ended June 30, 2012 and 2011, respectively.

Nonvested Stock Activity

During the six months ended June 30, 2012, we granted 50,420 shares of nonvested common stock as incentives to certain employees, including 14,308 shares for the annual directors' grant. Assuming continued service through each vesting date, the majority of these awards will vest in four equal annual installments beginning February 2013 through April 2016.

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

7. Share-Based Compensation, continued

Total compensation cost charged against income related to nonvested stock awards was \$3.3 million and \$1.1 million for the three months ended June 30, 2012 and 2011, respectively. The corresponding income tax benefit recognized in the income statement was \$1.3 million and \$436,000 for the three months ended June 30, 2012 and 2011, respectively. Total compensation cost charged against income related to nonvested stock awards was \$7.0 million and \$1.8 million for the six months ended June 30, 2012 and 2011, respectively. The corresponding income tax benefit recognized in the income statement was \$2.7 million and \$717,000 for the six months ended June 30, 2012 and 2011, respectively. At June 30, 2012, there was \$16.5 million of unrecognized compensation cost related to these nonvested shares, which will be recognized over a weighted-average period of 2.9 years. A summary of our nonvested stock activity for the six months ended June 30, 2012 is as follows:

| | Shares | Grant Date Weighted- Average Fair Value Per Share |
|----------------------------------|--------|---|
| Outstanding at December 31, 2011 | 1,516 | \$20.76 |
| Granted | 50 | \$22.32 |
| Vested | (364 |) \$22.68 |
| Forfeited/Canceled | 2 | \$25.10 |
| Outstanding at June 30, 2012 | 1,204 | \$20.25 |

8. Calculation of Earnings per Share

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

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|----------|------------------|----------|
| | June 30, 2012 | 2011 | June 30, 2012 | 2011 |
| Net income attributable to VCA Antech, Inc | \$34,320 | \$39,612 | \$69,565 | \$68,451 |
| Weighted-average common shares outstanding: | | | | |
| Basic | 87,589 | 86,535 | 87,443 | 86,445 |
| Effect of dilutive potential common shares: | | | | |
| Stock options | 550 | 647 | 555 | 664 |
| Nonvested shares | 584 | 122 | 557 | 194 |
| Diluted | 88,723 | 87,304 | 88,555 | 87,303 |
| Basic earnings per share | \$0.39 | \$0.46 | \$0.80 | \$0.79 |
| Diluted earnings per share | \$0.39 | \$0.45 | \$0.79 | \$0.78 |

For the three months ended June 30, 2012 and 2011, potential common shares of 1,047,701 and 1,139,567, respectively, were excluded from the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

For the six months ended June 30, 2012 and 2011, potential common shares of 1,050,520 and 40,067, respectively, were excluded from the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

9. Lines of Business

Our reportable segments are Animal Hospital and Laboratory. Our Animal Hospital segment provides veterinary services for companion animals and sells related retail and pharmaceutical products. Our Laboratory segment provides diagnostic laboratory testing services for veterinarians, both associated with our animal hospitals and those independent of us. Our other operating segments included in "All Other" in the following tables are our Medical Technology business, which sells digital radiography and ultrasound imaging equipment, related computer hardware, software and ancillary services to the veterinary market and our Vetstreet and ThinkPets businesses, which provides online communications, professional education, marketing solutions to the veterinary community and an ecommerce platform for independent animal hospitals. These operating segments do not meet the quantitative requirements for reportable segments. Our operating segments are strategic business units that have different services, products and/or functions. The segments are managed separately because each is a distinct and different business venture with unique challenges, risks and rewards. We also operate a corporate office that provides general and administrative support services for our other segments.

The accounting policies of our segments are essentially the same as those described in the summary of significant accounting policies included in our 2011 Annual Report on Form 10-K. We evaluate the performance of our segments based on gross profit and operating income. For purposes of reviewing the operating performance of our segments all intercompany sales and purchases are generally accounted for as if they were transactions with independent third parties at current market prices.

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

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

9. Lines of Business, continued

| | Animal Hospital | Laboratory | All Other | Corporate | Intercompany Eliminations | Total |
|---|--------------------|------------|-----------|------------|------------------------------|------------|
| Three Months Ended | | | | | | |
| June 30, 2012 | | | | | | |
| External revenue | \$342,282 | \$72,452 | \$23,638 | \$— | \$— | \$438,372 |
| Intercompany revenue | — | 14,168 | 3,780 | — | (17,948) |) — |
| Total revenue | 342,282 | 86,620 | 27,418 | — | (17,948) |) 438,372 |
| Direct costs | 292,902 | 44,324 | 17,624 | — | (17,085) |) 337,765 |
| Gross profit | 49,380 | 42,296 | 9,794 | — | (863) |) 100,607 |
| Selling, general and administrative expense | 7,995 | 7,510 | 9,029 | 14,463 | — | 38,997 |
| Net (gain) loss on sale and disposal of assets | (112) |) (7) |) 232 | (1) |) — | 112 |
| Operating income (loss) | \$41,497 | \$34,793 | \$533 | \$(14,462) |) \$(863) |) \$61,498 |
| Depreciation and amortization | \$15,239 | \$2,521 | \$2,582 | \$804 | \$(345) |) \$20,801 |
| Property and equipment additions | \$15,297 | \$2,282 | \$1,048 | \$3,008 | \$(542) |) \$21,093 |
| Three Months Ended | | | | | | |
| June 30, 2011 | | | | | | |
| External revenue | \$291,332 | \$72,955 | \$11,818 | \$— | \$— | \$376,105 |
| Intercompany revenue | — | 11,430 | 4,391 | — | (15,821) |) — |
| Total revenue | 291,332 | 84,385 | 16,209 | — | (15,821) |) 376,105 |
| Direct costs | 238,392 | 43,716 | 11,419 | — | (14,254) |) 279,273 |
| Gross profit | 52,940 | 40,669 | 4,790 | — | (1,567) |) 96,832 |
| Selling, general and administrative expense | 6,044 | 6,853 | 3,584 | 10,182 | — | 26,663 |
| Net loss on sale and disposal of assets | 51 | 7 | 2 | — | — | 60 |
| Operating income (loss) | \$46,845 | \$33,809 | \$1,204 | \$(10,182) |) \$(1,567) |) \$70,109 |
| Depreciation and amortization | \$9,533 | \$2,508 | \$668 | \$685 | \$(318) |) \$13,076 |
| Property and equipment additions | \$13,236 | \$1,728 | \$258 | \$1,627 | \$(449) |) \$16,400 |

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

9. Lines of Business, continued

| | Animal Hospital | Laboratory | All Other | Corporate | Intercompany Eliminations | Total |
|---|--------------------|------------|-----------|--------------|------------------------------|---------------|
| Six Months Ended | | | | | | |
| June 30, 2012 | | | | | | |
| External revenue | \$658,407 | \$144,423 | \$45,007 | \$— | \$— | \$847,837 |
| Intercompany revenue | — | 26,927 | 8,736 | — | (35,663) |) — |
| Total revenue | 658,407 | 171,350 | 53,743 | — | (35,663) |) 847,837 |
| Direct costs | 563,471 | 88,503 | 35,282 | — | (33,405) |) 653,851 |
| Gross profit | 94,936 | 82,847 | 18,461 | — | (2,258) |) 193,986 |
| Selling, general and administrative expense | 15,052 | 15,108 | 18,312 | 29,576 | — | 78,048 |
| Net loss (gain) on sale and disposal of assets | 393 | (14) |) 240 | 16 | — | 635 |
| Operating income (loss) | \$79,491 | \$67,753 | \$(91) |) \$(29,592) |) \$(2,258) |) \$115,303 |
| Depreciation and amortization | \$26,583 | \$5,074 | \$4,845 | \$1,568 | \$(707) |) \$37,363 |
| Property and equipment additions | \$26,063 | \$3,349 | \$2,770 | \$5,991 | \$(1,008) |) \$37,165 |
| Six Months Ended | | | | | | |
| June 30, 2011 | | | | | | |
| External revenue | \$561,273 | \$142,051 | \$27,904 | \$— | \$— | \$731,228 |
| Intercompany revenue | — | 21,883 | 7,401 | — | (29,284) |) — |
| Total revenue | 561,273 | 163,934 | 35,305 | — | (29,284) |) 731,228 |
| Direct costs | 468,780 | 86,535 | 26,057 | — | (26,754) |) 554,618 |
| Gross profit | 92,493 | 77,399 | 9,248 | — | (2,530) |) 176,610 |
| Selling, general and administrative expense | 12,127 | 13,489 | 7,140 | 20,090 | — | 52,846 |
| Net loss on sale and disposal of assets | 129 | 18 | 2 | — | — | 149 |
| Operating income (loss) | \$80,237 | \$63,892 | \$2,106 | \$(20,090) |) \$(2,530) |) \$123,615 |
| Depreciation and amortization | \$19,406 | \$4,979 | \$1,325 | \$1,365 | \$(619) |) \$26,456 |
| Property and equipment additions | \$22,771 | \$2,964 | \$1,017 | \$2,585 | \$(903) |) \$28,434 |
| At June 30, 2012 | | | | | | |
| Total assets | \$1,578,725 | \$244,360 | \$219,390 | \$132,700 | \$(23,980) |) \$2,151,195 |
| At December 31, 2011 | | | | | | |
| Total assets | \$1,439,103 | \$232,423 | \$202,187 | \$142,793 | \$(21,138) |) \$1,995,368 |

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

10. Commitments and Contingencies

We have certain commitments, including operating leases and acquisition agreements. These items are discussed in detail in our consolidated financial statements and notes thereto included in our 2011 Annual Report on Form 10-K. We also have contingencies as follows:

a. Earn-Out Payments

We have contractual arrangements in connection with certain acquisitions that were accounted for under previous business combinations accounting guidance, whereby additional cash may be paid to former owners of acquired companies upon attainment of specified financial criteria as set forth in the respective agreements. The amount to be paid cannot be determined until the earn-out periods expire and the attainment of criteria is established. If the specified financial criteria are attained, we will be obligated to pay approximately, an additional \$925,000. Under the current business combination accounting guidance, contingent consideration, such as earn-out liabilities, is recognized as part of the consideration transferred on the acquisition date. A corresponding liability is recorded based on the fair value of the liability if the fair value is known or determinable. The changes in fair value are recognized in earnings where applicable for each reporting period.

b. Other Contingencies

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

11. Income Taxes

The effective rates for the three and six months ended June 30, 2012, were 38.5% and 37.0%, as compared to the three and six months ended June 30, 2011, of 39.2% and 39.4%, respectively. The decreases in rates are in part due to the non-taxable gain of \$5.7 million related to the increase in value of our historic noncontrolling interest in AVC realized upon the acquisition of the remaining equity interest in addition to lower tax rates in Canada.

12. Noncontrolling Interests

We own some of our animal hospitals in partnerships with noncontrolling interest holders. We consolidate our partnerships in our consolidated financial statements because our ownership interest in these partnerships is equal to or greater than 50.1% and we control these entities. We record noncontrolling interest in income of subsidiaries equal to our partners' percentage ownership of the partnerships' income. We also record changes in the redemption value of our redeemable noncontrolling interests in net income attributable to noncontrolling interests in our condensed, consolidated income statements. We reflect our noncontrolling partners' cumulative share in the equity of the respective partnerships as either noncontrolling interests in equity, mandatorily redeemable noncontrolling interests in other liabilities, or redeemable noncontrolling interests in temporary equity (mezzanine).

a. Mandatorily Redeemable Noncontrolling Interests

The terms of some of our partnership agreements require us to purchase the partner's equity in the partnership in the event of the partner's death. We report these redeemable noncontrolling interests at their estimated redemption value and classify them as liabilities due to the certainty of the related event. We recognize redemption value changes in the obligation in interest expense. At June 30, 2012 and December 31, 2011, these liabilities were \$11.3 million and \$3.1

million, respectively, and are included in other liabilities in our consolidated balance sheets.

b. Redeemable Noncontrolling Interests

We also enter into partnership agreements whereby the minority partner is issued certain “put” rights. These rights are normally exercisable at the sole discretion of the minority partner. We report these redeemable noncontrolling interests at their estimated redemption value and classify them in temporary equity (mezzanine). We recognize changes in the obligation in net income attributable to noncontrolling interests.

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

12. Noncontrolling Interests, continued

The following table provides a summary of redeemable noncontrolling interests (in thousands):

| | Income Statement Impact | Redeemable Noncontrolling Interests |
|--|-------------------------------|---|
| Balance as of December 31, 2010 | | \$5,799 |
| Noncontrolling interest | \$428 | |
| Redemption value change | 402 | 830 |
| Distribution to noncontrolling interests | | (372) |
| Balance as of June 30, 2011 | | \$6,257 |
| Balance as of December 31, 2011 | | \$6,964 |
| Noncontrolling interest | \$446 | |
| Redemption value change | 17 | 463 |
| Distribution to noncontrolling interests | | (442) |
| Balance as of June 30, 2012 | | \$6,985 |

13. Recent Accounting Pronouncements

In June 2011, the FASB finalized the accounting guidance for the Presentation of Comprehensive Income. The objective of the new guidance is to improve the comparability, consistency, and transparency of financial reporting, to increase the prominence of the items reported in other comprehensive income and to facilitate convergence of GAAP and IFRS. The guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholder's equity and requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. Regardless of which option is chosen, it is required that reclassification adjustments for items that are reclassified from other comprehensive income to net income be presented on the face of the financial statements.

The new guidance does not change the following: the items that must be reported in other comprehensive income; when an item of other comprehensive income must be reclassified to net income; the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects with a single amount shown for aggregate income tax expense; and does not affect how earnings per share is calculated or presented.

The guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. Early adoption was permitted. We adopted the new accounting guidance on January 1, 2012. The adoption did not significantly impact our consolidated financial statements other than the changes to presentation outlined.

In December 2011, the FASB deferred the effective date for amendments to the presentation of reclassifications of items out of accumulated other comprehensive income. The effective date deferral is to allow the FASB to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income.

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2012
(Unaudited)

13. Recent Accounting Pronouncements, continued

In September 2011, the FASB amended the accounting guidance on Intangibles--Goodwill and Other - Testing Goodwill for Impairment. The objective of this guidance is to reduce the cost and complexity of performing the annual goodwill impairment test and to improve the previous guidance by expanding the examples of events and circumstances that an entity should consider in the qualitative evaluation about the likelihood of goodwill impairment. The amendments allow an entity the option of first assessing qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

The examples of events and circumstances included in the amendment that an entity should consider in performing its qualitative assessment about whether to proceed to the first step of the goodwill impairment test supersede the examples in the existing guidance. If it is determined that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. Under the amendments, an entity has the option to bypass the qualitative assessment for any reporting unit in any period and may resume performing the qualitative assessment in any subsequent period. An entity is no longer permitted to carry forward its detailed calculation of a reporting unit's fair value from a prior year as previously permitted under the existing guidance. The amended guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 with early adoption permitted. We adopted the amended goodwill impairment testing procedures on January 1, 2012. The adoption does not significantly impact our consolidated financial statements.

In July 2012, the FASB issued accounting guidance on testing indefinite-lived intangible assets for impairment. The objective of this guidance is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test. An entity will have an option not to calculate annually the fair value of an indefinite-lived intangible asset if the entity determines that it is not more likely than not that the asset is impaired. Permitting an entity to assess qualitative factors when testing indefinite-lived intangible assets for impairment results in guidance that is similar to the goodwill impairment testing guidance, as mentioned above. The amended guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. We currently do not have any indefinite-lived intangible assets.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

| | Page |
|---|-----------|
| <u>Introduction</u> | <u>21</u> |
| <u>Executive Overview</u> | <u>21</u> |
| <u>Critical Accounting Policies</u> | <u>24</u> |
| <u>Consolidated Results of Operations</u> | <u>25</u> |
| <u>Segment Results</u> | <u>26</u> |
| <u>Liquidity and Capital Resources</u> | <u>30</u> |

Introduction

The following discussion should be read in conjunction with our condensed, consolidated financial statements provided under Part I, Item I of this Quarterly report on Form 10-Q. We have included herein statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We generally identify forward-looking statements in this report using words like “believe,” “intend,” “expect,” “estimate,” “may,” “plan,” “should plan,” “project,” “contemplate,” “anticipate,” “predict,” “potential,” “continue,” or similar expressions. 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 are described throughout this report and in our Annual Report on Form 10-K, particularly in “Risk Factors,” Part I, Item 1A of that report.

The forward-looking information set forth in this Quarterly Report on Form 10-Q is as of August 9, 2012, and we undertake no duty to update this information unless required by law. Shareholders and prospective investors can find information filed with the SEC after August 9, 2012 at our website at <http://investor.vcaantech.com> or at the SEC’s website at www.sec.gov.

We are a leading international 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. We also provide both online and printed communications, education and information, and analytical based marketing solutions to the veterinary community.

Our reportable segments are as follows:

Our Animal Hospital segment operates the largest network of freestanding, full-service animal hospitals in the United States and Canada. Our animal hospitals offer a full range of general medical and surgical services for companion animals. We treat diseases and injuries, offer pharmaceutical and retail products and perform a variety of pet wellness programs, including health examinations, diagnostic testing, routine vaccinations, spaying, neutering and dental care. At June 30, 2012, our animal hospital network consisted of 592 animal hospitals in 41 states and in three Canadian provinces.

Our Laboratory segment operates the largest network of veterinary diagnostic laboratories in the nation. Our laboratories provide sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. At June 30, 2012, our laboratory network consisted of 54 laboratories serving all 50 states and certain areas in Canada.

Our “All Other” category includes the results of our Medical Technology, Vetstreet and ThinkPets operating segments. Each of these segments did not meet the materiality thresholds to be reported individually.

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

The fluctuating and slow pace of the economic recovery and continued competition predominantly in the laboratory business, continues to impact our revenue. We are unable to forecast the timing or degree of any economic recovery. Further, trends in the general economy may not be reflected in our business at the same time or in the same degree as in the general economy. The timing and degree of any economic recovery, and its impact on our business, are among the important factors that could cause our actual results to differ from our forward-looking information.

Executive Overview

During the three and six months ended June 30, 2012, we achieved an increase in consolidated revenue primarily from acquired animal hospitals and other acquired businesses, as well as, organic growth in our animal hospital and laboratory businesses. Our Animal Hospital same-store revenue increased 0.2% for the three months ended June 30, 2012 and our Animal Hospital same-store revenue, adjusted for one additional business day, increased 1.2% for the six months ended June 30, 2012. Our Laboratory internal revenue increased 2.6% and 3.8% for the three and six

months ended June 30, 2012, respectively. Our

21

overall operating income declined as compared to the prior-year comparable periods. The decline was primarily due to a decrease in gross margins in our Animal Hospital Segment, which was caused by an increase in labor and other costs, a \$2.7 million out-of-period adjustment to depreciation expense related to our acquired capital leases and increased selling, general and administrative expenses.

Financing Transaction

On January 25, 2012 we amended our Amended and Restated Credit and Guaranty Agreement, dated as of August 16, 2011. The amendment replenishes the aggregate amount of uncommitted incremental facilities available under our senior credit facility to a maximum of \$100 million, after giving effect to the funding of \$50 million of new term loan commitments on January 24, 2012, which were drawn in connection with the additional investment made in Associate Veterinary Clinics (1981) LTD ("AVC"), detailed below.

Acquisitions

Our growth strategy includes the acquisition of independent animal hospitals. We currently anticipate that we will acquire \$90 million to \$120 million of annualized Animal Hospital revenue in 2012, in addition to the acquisition of AVC. We evaluate the acquisition of animal hospital chains and laboratories, or related businesses, if favorable opportunities are presented. The following table summarizes the changes in the number of facilities operated by our Animal Hospital and Laboratory segments during the six months ended June 30, 2012:

| | | |
|-----------------------------|-----|---|
| Animal Hospitals: | | |
| Beginning of period | 541 | |
| Acquisitions, excluding AVC | 14 | |
| Acquisitions, merged | (3 |) |
| AVC | 44 | |
| Sold, closed or merged | (4 |) |
| End of period | 592 | |

Laboratories:

| | |
|---------------------|----|
| Beginning of period | 53 |
| Created | 1 |
| End of period | 54 |

The following table summarizes the aggregate consideration for the 14 independent animal hospitals acquired during the six months ended June 30, 2012, and the allocation of the acquisition price (in thousands):

Consideration:

| | |
|---|----------|
| Cash | \$19,193 |
| Holdback | 475 |
| Fair value of total consideration transferred | \$19,668 |

Allocation of the Purchase Price:

| | |
|--------------------------------|----------|
| Tangible assets | \$780 |
| Identifiable intangible assets | 3,134 |
| Goodwill ⁽¹⁾ | 15,754 |
| Total | \$19,668 |

⁽¹⁾ We expect that \$11.8 million of the goodwill recorded for these acquisitions, as of June 30, 2012, will be deductible for income tax purposes.

Associate Veterinary Clinics (1981) LTD Investment

On January 31, 2012, we increased our investment in AVC by approximately CDN \$81 million (approximately US \$81 million) becoming the sole non-veterinarian shareholder of AVC. At the time of the additional investment, AVC operated 44 animal hospitals in three Canadian provinces, offering services ranging from primary care, to specialty referral services and 24-hour emergency care. This investment and planned additional investments in AVC will facilitate our continued expansion in the Canadian market. At the time of the investment, AVC had annualized revenue of approximately CDN \$95 million (approximately US \$95 million). Our consolidated financial statements reflect the operating results of AVC since January 31, 2012.

The following table summarizes the total investment and the preliminary allocation of the investment in AVC (in thousands):

Consideration:

| | |
|---|----------|
| Cash | \$48,891 |
| Cash paid to debt holders | 25,915 |
| Fair value of total consideration transferred | \$74,806 |

Allocation of the Purchase Price:

| | |
|--|-----------|
| Tangible assets | \$11,744 |
| Identifiable intangible assets | 14,124 |
| Goodwill ⁽¹⁾ | 87,073 |
| Other liabilities assumed | (18,124) |
| | 94,817 |
| Noncontrolling interest | (8,161) |
| Fair value of pre-existing investment in AVC | (11,850) |
| Total | \$74,806 |

⁽¹⁾ As of June 30, 2012, we have not finalized the determination of the amount of goodwill that will be deductible for income tax purposes.

The allocation of the additional investment is preliminary, because certain events have not occurred or have not been completed or finalized, including but not limited to, the valuation of assets, including intangible assets, and liabilities. The pro forma impacts on revenue and earnings have not been disclosed as the amounts were immaterial to the financial statements as a whole.

ThinkPets Inc. ("ThinkPets")

On February 1, 2012, we acquired 100% interest in ThinkPets for \$21 million, payable by delivery of 473,389 shares of VCA common stock and \$10.5 million in cash. We intend to consolidate the business of ThinkPets with our Vetstreet business, which we expect will improve the products and services it offers to clients of both companies. Our consolidated financial statements reflect the operating results of ThinkPets since February 1, 2012.

The following table summarizes the preliminary purchase price and the preliminary allocation of the investment in ThinkPets (in thousands):

Consideration:

| | |
|---|----------|
| Cash | \$7,468 |
| Issuance of common stock for acquisitions | 10,500 |
| Holdback | 1,050 |
| Fair value of total consideration transferred | \$19,018 |

Allocation of the Purchase Price:

| | |
|--------------------------------|----------|
| Tangible assets | \$2,573 |
| Identifiable intangible assets | 7,350 |
| Goodwill ⁽¹⁾ | 10,569 |
| Other liabilities assumed | (1,474) |
| Total | \$19,018 |

⁽¹⁾ As of June 30, 2012, we have not finalized the determination of the amount of goodwill that will be deductible for income tax purposes.

The allocation of the purchase price is preliminary because certain events have not occurred or have not been completed or finalized, including but not limited to, the valuation of assets, including intangible assets, and liabilities. The pro forma impacts on revenue and earnings have not been disclosed as the amounts were immaterial to the financial statements as a whole.

Critical Accounting Policies

Our consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”), which require management to make estimates and assumptions that affect reported amounts. The estimates and assumptions are based on historical experience and on other factors that management believes to be reasonable. Actual results may differ from those estimates. Critical accounting policies represent the areas where more significant judgments and estimates are used in the preparation of our consolidated financial statements. A discussion of such critical accounting policies, which include revenue recognition, other intangible assets, capitalized software costs, income taxes, and self-insured liabilities can be found in our 2011 Annual Report on Form 10-K. There have been no material changes to the policies noted above as of this quarterly report on Form 10-Q for the period ended June 30, 2012. A summary of our valuation of goodwill accounting policy is discussed below.

Valuation of Goodwill

At June 30, 2012, we had \$1.3 million of goodwill, accounting for 63% of our total assets. 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.

We test our goodwill for impairment annually, or sooner if circumstances indicate impairment may exist, in accordance with goodwill guidance. We adopted the end of October as our annual impairment testing date, which allows us 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 and Exchange Commission (“SEC”) in accordance with our accelerated filing requirements. We monitor our reporting units on a quarterly basis and have not identified any events subsequent to the 2011 testing date which would indicate any impairment may have occurred in any of our reporting units.

The recognition and measurement of a goodwill impairment loss currently 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, with carrying value defined as the reporting unit's net assets, including goodwill. 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.

If we identify a potential impairment in the first step, we then 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 units' 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.

Our estimated fair values are calculated in accordance with generally accepted accounting principles related to fair value and utilize generally accepted valuation techniques consisting primarily of discounted cash flow techniques and market comparables, where applicable. These valuation methods involve the use of significant assumptions and estimates such as forecasted growth rates, valuation multiples, the weighted-average cost of capital, and risk premiums, which are based upon the best available market information and are consistent with our long-term strategic plans. Changes in our estimates, such as, forecasted cash flows, could affect the estimated fair value of our reporting units and could result in a goodwill impairment charge that could be material particularly for our Animal Hospital reporting unit.

Our Animal Hospital reporting unit, which has approximately \$1.1 billion of goodwill as of June 30, 2012, marginally exceeded its carrying value during the 2011 testing. Negative changes in the undiscounted cash flows related to variables, such as revenue growth rates, margins, or the discount rate, could result in a decrease in the estimated fair value of our Animal Hospital reporting unit and could ultimately result in a substantial goodwill impairment charge. The performance of our Animal Hospital reporting unit, and in turn, the risk of goodwill impairment, is subject to a number of risks and uncertainties, some of which are outside of our control.

Consolidated Results of Operations

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | | | |
|---|--------------------------------|--------|------------------------------|--------|---|--|
| | 2012 | 2011 | 2012 | 2011 | | |
| Revenue: | | | | | | |
| Animal Hospital | 78.1 | % 77.5 | % 77.7 | % 76.8 | % | |
| Laboratory | 19.8 | 22.4 | 20.2 | 22.4 | | |
| All Other | 6.2 | 4.3 | 6.3 | 4.8 | | |
| Intercompany | (4.1 |) (4.2 |) (4.2 |) (4.0 |) | |
| Total revenue | 100.0 | 100.0 | 100.0 | 100.0 | | |
| Direct costs | 77.0 | 74.3 | 77.1 | 75.8 | | |
| Gross profit | 23.0 | 25.7 | 22.9 | 24.2 | | |
| Selling, general and administrative expense | 9.0 | 7.1 | 9.3 | 7.3 | | |
| Operating income | 14.0 | 18.6 | 13.6 | 16.9 | | |
| Interest expense, net | 1.0 | 1.2 | 1.0 | 1.2 | | |
| Business combination adjustment gain | — | — | (0.7 |) — | | |
| Income before provision for income taxes | 13.0 | 17.4 | 13.3 | 15.7 | | |
| Provision for income taxes | 4.9 | 6.7 | 4.8 | 6.1 | | |
| Net income | 8.1 | 10.7 | 8.5 | 9.6 | | |
| Net income attributable to noncontrolling interests | 0.3 | 0.2 | 0.3 | 0.2 | | |
| Net income attributable to VCA Antech, Inc | 7.8 | % 10.5 | % 8.2 | % 9.4 | % | |

Revenue

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

| | Three Months Ended | | | | | Six Months Ended | | | | |
|------------------------|--------------------|------------|-----------|------------|-----------|------------------|------------|-----------|------------|----------|
| | June 30, 2012 | | 2011 | | % Change | June 30, 2012 | | 2011 | | % Change |
| | \$ | % of Total | \$ | % of Total | | \$ | % of Total | \$ | % of Total | |
| Animal Hospital | \$342,282 | 78.1 % | \$291,332 | 77.5 % | 17.5 % | \$658,407 | 77.7 % | \$561,273 | 76.8 % | 17.3 % |
| Laboratory | 86,620 | 19.8 % | 84,385 | 22.4 % | 2.6 % | 171,350 | 20.2 % | 163,934 | 22.4 % | 4.5 % |
| All Other | 27,418 | 6.2 % | 16,209 | 4.3 % | 69.2 % | 53,743 | 6.3 % | 35,305 | 4.8 % | 52.2 % |
| Intercompany (17,948) | (4.1)% | (15,821) | (4.2)% | 13.4 % | (35,663) | (4.2)% | (29,284) | (4.0)% | 21.8 % | |
| Total revenue | \$438,372 | 100.0 % | \$376,105 | 100.0 % | 16.6 % | \$847,837 | 100.0 % | \$731,228 | 100.0 % | 15.9 % |

Consolidated revenue increased \$62.3 million for the three months ended June 30, 2012, and \$116.6 million for the six months ended June 30, 2012, as compared to the same periods in the prior year. The increases were primarily attributable to revenue from acquisitions including animal hospitals, Vetstreet and ThinkPets in addition to organic revenue from both our animal hospital and laboratory operations. Excluding the impact of acquisitions, revenue remained relatively flat for the three months ended June 30, 2012, and revenue increased \$7.4 million for the six months ended June 30, 2012, primarily related to organic growth in our laboratory business.

Gross Profit

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

| | Three Months Ended | | | | | Six Months Ended | | | | |
|---------------------|--------------------|--------------|----------|--------------|----------|------------------|--------------|-----------|--------------|----------|
| | June 30, 2012 | | 2011 | | % Change | June 30, 2012 | | 2011 | | % Change |
| | \$ | Gross Margin | \$ | Gross Margin | | \$ | Gross Margin | \$ | Gross Margin | |
| Animal Hospital | \$49,380 | 14.4 % | \$52,940 | 18.2 % | (6.7)% | \$94,936 | 14.4 % | \$92,493 | 16.5 % | 2.6 % |
| Laboratory | 42,296 | 48.8 % | 40,669 | 48.2 % | 4.0 % | 82,847 | 48.3 % | 77,399 | 47.2 % | 7.0 % |
| All Other | 9,794 | 35.7 % | 4,790 | 29.6 % | 104.5 % | 18,461 | 34.4 % | 9,248 | 26.2 % | 99.6 % |
| Intercompany (863) | | | (1,567) | | | (2,258) | | (2,530) | | |
| Total gross profit | \$100,607 | 23.0 % | \$96,832 | 25.7 % | 3.9 % | \$193,986 | 22.9 % | \$176,610 | 24.2 % | 9.8 % |

Consolidated gross profit increased \$3.8 million for the three months ended June 30, 2012 and \$17.4 million for the six months ended June 30, 2012, as compared to the same periods in the prior year. The increases were primarily due to gross profit from acquisitions and internal revenue growth in our Laboratory segment. Excluding acquisitions, gross profit declined \$3.2 million or 1.8%, for the six months ended June 30, 2012 primarily due to decreased margins in our Animal Hospital segment, which resulted from increased labor and other costs combined with a \$3.1 million adjustment to depreciation expense related to acquired capital leases.

Segment Results

Animal Hospital Segment

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

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|--------------|--------------------------------|-----------|----------|------------------------------|-----------|----------|
| | 2012 | 2011 | % Change | 2012 | 2011 | % Change |
| Revenue | \$342,282 | \$291,332 | 17.5 % | \$658,407 | \$561,273 | 17.3 % |
| Gross profit | \$49,380 | \$52,940 | (6.7) % | \$94,936 | \$92,493 | 2.6 % |
| Gross margin | 14.4 % | 18.2 % | | 14.4 % | 16.5 % | |

Animal Hospital revenue increased \$51.0 million for the three months ended June 30, 2012 and \$97.1 million for the six months ended June 30, 2012, as compared to the same periods in the prior year. The components of the increases are summarized in the following table (in thousands, except percentages and average revenue per order):

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|--|--------------------------------|-----------|----------|------------------------------|-----------|----------|
| | 2012 | 2011 | % Change | 2012 | 2011 | % Change |
| Same-store facilities: | | | | | | |
| Orders ⁽¹⁾ | 1,751 | 1,786 | (2.0) % | 3,391 | 3,436 | (1.3) % |
| Average revenue per order ⁽²⁾ | \$165.58 | \$162.04 | 2.2 % | \$165.89 | \$161.77 | 2.5 % |
| Same-store revenue ⁽¹⁾ | \$289,994 | \$289,367 | 0.2 % | \$562,471 | \$555,872 | 1.2 % |
| Business day adjustment ⁽³⁾ | — | — | | 3,542 | — | |
| Net acquired revenue ⁽⁴⁾ | 52,288 | 1,965 | | 92,394 | 5,401 | |
| Total | \$342,282 | \$291,332 | 17.5 % | \$658,407 | \$561,273 | 17.3 % |

Same-store revenue and orders were calculated using Animal Hospital operating results, adjusted to exclude the

(1) operating results for newly acquired animal hospitals that we did not own as of the beginning of the comparable period in the prior year. Same-store revenue also includes revenue generated by customers referred from our relocated or combined animal hospitals, including those merged upon acquisition.

(2) Computed by dividing same-store revenue by same-store orders. The average revenue per order may not calculate exactly due to rounding.

(3) The 2012 business day adjustment reflects the impact of one additional business day in 2012, as compared to 2011.

Net acquired revenue represents the revenue from animal hospitals acquired, net of revenue from animal hospitals sold or closed, on or after the beginning of the comparable period, which was April 1, 2011 for the three month

(4) analysis and January 1, 2011 for the six month analysis. Fluctuations in net acquired revenue occur due to the volume, size, and timing of acquisitions and dispositions during the periods from this date through the end of the applicable period.

During the three and six months ended June 30, 2012, the slow economic recovery and the wide availability of many pet-related products, traditionally sold in our animal hospitals, in retail stores and other distribution channels such as the Internet continues to contribute to the decline in our volume of same-store orders.

In addition, our business strategy is to place a greater emphasis on comprehensive wellness visits and advanced medical procedures, which typically generate higher priced orders. The migration of lower priced orders from our animal hospitals to other distribution channels mentioned above and our emphasis on comprehensive wellness visits has, over the past several years, resulted in a decrease in lower priced orders and an increase in higher priced orders. During the three and six months ended June 30, 2012, we experienced a decrease in the number of both lower and higher priced orders, which we believe continues to be a consequence of the slow economic recovery and the impact of changes in our overall business environment on the mix of procedures performed.

Price increases contributed to the increase in the average revenue per order. Prices at each of our animal hospitals are reviewed regularly and adjustments are made based on market considerations, demographics and our costs. These adjustments historically have

approximated 3% to 6% on most services at the majority of our animal hospitals and are typically implemented in February of each year; price increases in 2012, however, approximated 3% to 4% on most services at the majority of our animal hospitals.

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

Our consolidated Animal Hospital gross margin decreased to 14.4% for the three and six months ended June 30, 2012, as compared to 18.2% and 16.5% for the three and six months ended June 30, 2011, respectively. Our same-store gross margin decreased to 14.5% and 14.7% for the three and six months ended June 30, 2012, respectively as compared to 18.3% and 16.6% for the respective prior year periods.

The decrease in gross margin for the three and six months ended June 30, 2012, was primarily attributable to increase in labor and other costs combined with the impact of deleverage and an out-of-period adjustment to depreciation expense of \$2.7 million.

Over the last several years we have acquired a significant number of animal hospitals. Certain newly acquired animal hospitals have a lower gross margin at the time of acquisition than our same-store facilities. Subsequently, we have improved the gross margin at our acquired animal hospitals, in the aggregate, by reducing costs and/or increasing operating leverage.

Laboratory Segment

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

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | | | |
|--------------|--------------------------------|--------|----------|------------------------------|---------|----------|---|--|
| | 2012 | 2011 | % Change | 2012 | 2011 | % Change | | |
| Revenue | 86,620 | 84,385 | 2.6 | % 171,350 | 163,934 | 4.5 | % | |
| Gross profit | 42,296 | 40,669 | 4.0 | % 82,847 | 77,399 | 7.0 | % | |
| Gross margin | 48.8 | % 48.2 | % | 48.3 | % 47.2 | % | | |

Laboratory revenue increased \$2.2 million for the three months ended June 30, 2012 and increased \$7.4 million for the six months ended June 30, 2012, as compared to the same periods in the prior year. The components of the changes in Laboratory revenue are detailed below (in thousands, except percentages and average revenue per requisition):

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | | | |
|--|--------------------------------|----------|----------|------------------------------|-----------|----------|---|--|
| | 2012 | 2011 | % Change | 2012 | 2011 | % Change | | |
| Internal growth: | | | | | | | | |
| Number of requisitions ⁽¹⁾ | 3,426 | 3,406 | 0.6 | % 6,585 | 6,458 | 2.0 | % | |
| Average revenue per requisition ⁽²⁾ | \$25.27 | \$24.78 | 2.0 | % \$25.84 | \$25.38 | 1.8 | % | |
| Total internal revenue ⁽¹⁾ | \$86,582 | \$84,385 | 2.6 | % \$170,164 | \$163,934 | 3.8 | % | |
| Billing day adjustment ⁽³⁾ | — | \$— | | 1,106 | — | | | |
| Acquired revenue ⁽⁴⁾ | 38 | — | | 80 | — | | | |
| Total | \$86,620 | \$84,385 | 2.6 | % \$171,350 | \$163,934 | 4.5 | % | |

⁽¹⁾ Internal revenue and requisitions were calculated using Laboratory operating results, adjusted (i) to exclude the operating results of acquired laboratories that we did not own as of the beginning of the comparable period in the prior year, and (ii) for the impact resulting from any differences in the number of billing days in comparable

periods, if applicable.

- (2) Computed by dividing internal revenue by the number of requisitions.
- (3) The 2012 billing day adjustment reflects the impact of one additional billing day in 2012, as compared to 2011.

- (4) Acquired revenue represents the current year period revenue recognized from our acquired laboratories that we did not own as of the beginning of the comparable prior-year period.

The increase in Laboratory revenue for the three and six months ended June 30, 2012, was due to an increase in average revenue per requisition and an increase in the number of requisitions. In prior years, the significant increase in requisitions from internal growth have been driven by an ongoing 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 animal hospitals. These factors are also attributable to the increase in internal requisitions for the current year, although the effects are lessened due to the slow economic recovery and the continued effects of increased competition.

The average revenue per requisition increased slightly for the three and six months ended June 30, 2012, as compared to the prior periods, due to price increases in February 2012. The average revenue per requisition was also impacted by various factors, including increased pricing discounts, changes in the mix, and inclusion of lower-priced tests historically performed at the animal hospitals.

Laboratory gross profit is calculated as Laboratory revenue less Laboratory direct costs. Laboratory direct costs comprises 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.

Our Laboratory gross margin increased to 48.8% and 48.3% for the three and six months ended June 30, 2012, respectively, as compared to 48.2% and 47.2% in the prior-year periods. The increase in gross margin was primarily due to leverage related to the increase in revenue mentioned above. Specifically, salaries and related expenses and medical supply costs increased at a lesser rate compared to increased revenue.

Intercompany Revenue

Laboratory revenue, for the three and six months ended June 30, 2012, included intercompany revenue of \$14.2 million and \$26.9 million, respectively, generated by providing laboratory services to our animal hospitals. For purposes of reviewing the operating performance of our segments, all intercompany transactions are accounted for as if the transaction was with an independent third party at current market prices. For financial reporting purposes, intercompany transactions are eliminated as part of our consolidation.

Selling, General and Administrative Expense

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

| | Three Months Ended June 30, 2012 | | | | | Six Months Ended June 30, 2012 | | | | |
|-----------------|--|-----------------|----------|-----------------|-------------|--------------------------------------|-----------------|----------|-----------------|-------------|
| | \$ | % of Revenue | \$ | % of Revenue | % Change | \$ | % of Revenue | \$ | % of Revenue | % Change |
| Animal Hospital | \$7,995 | 2.3 % | \$6,044 | 2.1 % | 32.3 % | \$15,052 | 2.3 % | \$12,127 | 2.2 % | 24.1 % |
| Laboratory | 7,510 | 8.7 % | 6,853 | 8.1 % | 9.6 % | 15,108 | 8.8 % | 13,489 | 8.2 % | 12.0 % |
| All Other | 9,029 | 32.9 % | 3,584 | 22.1 % | 151.9 % | 18,312 | 34.1 % | 7,140 | 20.2 % | 156.5 % |
| Corporate | 14,463 | 3.3 % | 10,182 | 2.7 % | 42.0 % | 29,576 | 3.5 % | 20,090 | 2.7 % | 47.2 % |
| Total SG&A | \$38,997 | 9.0 % | \$26,663 | 7.1 % | 46.3 % | \$78,048 | 9.3 % | \$52,846 | 7.3 % | 47.7 % |

Consolidated SG&A increased by \$12.3 million and \$25.2 million for the three and six months ended June 30, 2012, respectively, compared to the prior-year periods. The increases in consolidated SG&A for the three and six months ended June 30, 2012 included \$6.3 million and \$12.2 million, respectively, from the addition of AVC, Vetstreet and ThinkPets. The increases in Corporate SG&A, included \$2.3 million and \$5.0 million for the three and six months ended June 30, 2012, respectively, due to additional share-based compensation related to grants issued during 2011. Additional increases of \$427,000 and \$1.3 million for the three and six months ended June 30, 2012, respectively,

were transaction costs related to acquisitions.

Operating Income

The following table summarizes our operating income in both dollars and as a percentage of applicable revenue (in thousands, except percentages):

| | Three Months Ended June 30, 2012 | | | | | Six Months Ended June 30, 2012 | | | | |
|------------------------|--|-----------------|-----------|-----------------|-------------|--------------------------------------|-----------------|-----------|-----------------|-------------|
| | \$ | % of Revenue | \$ | % of Revenue | % Change | \$ | % of Revenue | \$ | % of Revenue | % Change |
| Animal Hospital | \$41,497 | 12.1 % | \$46,845 | 16.1 % | (11.4) % | \$79,491 | 12.1 % | \$80,237 | 14.3 % | (0.9) % |
| Laboratory | 34,793 | 40.2 % | 33,809 | 40.1 % | 2.9 % | 67,753 | 39.5 % | 63,892 | 39.0 % | 6.0 % |
| All Other | 533 | 1.9 % | 1,204 | 7.4 % | (55.7) % | (91) | (0.2) % | 2,106 | 6.0 % | (104.3) % |
| Corporate | (14,462) | | (10,182) | | 42.0 % | (29,592) | | (20,090) | | 47.3 % |
| Intercompany | (863) | | (1,567) | | (44.9) % | (2,258) | | (2,530) | | (10.8) % |
| Total operating income | \$61,498 | 14.0 % | \$70,109 | 18.6 % | (12.3) % | \$115,303 | 13.6 % | \$123,615 | 16.9 % | (6.7) % |

The decrease in our consolidated operating income during the three and six months ended June 30, 2012 was primarily due to the decline in Animal Hospital margins, the aforementioned gross profit decrease, which included a \$2.7 million out-of-period adjustment to depreciation expense related to our acquired capital leases and increases in SG&A expenses.

Interest Expense, Net

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

| | Three Months Ended June 30, 2012 | | Six Months Ended June 30, 2011 | |
|--|--|---------|--------------------------------------|---------|
| | 2012 | 2011 | 2012 | 2011 |
| Interest expense: | | | | |
| Senior term notes | \$3,103 | \$3,045 | \$6,276 | \$6,182 |
| Capital leases and other | 1,054 | 1,304 | 1,849 | 1,973 |
| Amortization of debt costs | 321 | 386 | 642 | 774 |
| | 4,478 | 4,735 | 8,767 | 8,929 |
| Interest income | (114) | (160) | (316) | (335) |
| Total interest expense, net of interest income | \$4,364 | \$4,575 | \$8,451 | \$8,594 |

The decrease in net interest expense for the three and six months ended June 30, 2012 was primarily due to interest charged in the prior year comparable periods related to a mandatorily redeemable partnership interest correction, partially offset by an increase in interest expense from capital leases in the current year periods.

Provision for Income Taxes

The effective rate for the six months ended June 30, 2012 was 37.0%, as compared to 39.4% at June 30, 2011. The decrease in rate is in part due to (i) the non-taxable gain of \$5.7 million related to the increase in value of our historic noncontrolling interest in AVC realized upon the acquisition of the remaining equity interest and (ii) lower tax rates in Canada.

Liquidity and Capital Resources

Introduction

We generate cash primarily from (i) payments made by customers for our veterinary services, (ii) payments from animal hospitals and other clients for our laboratory services, (iii) proceeds received from the sale of our imaging equipment and other related services and (iv) payments received from participating hospitals for Vetstreet subscriptions and Vetstreet and ThinkPets reminder notices. Our business historically has experienced strong liquidity,

as fees for services provided in our animal

30

hospitals are due at the time of service and fees for laboratory services are collected under standard industry terms. Our cash disbursements are primarily for payments related to the compensation of our employees, supplies and inventory purchases for our operating segments, occupancy and other administrative costs, interest expense, payments on long-term borrowings, capital expenditures and acquisitions. Cash outflows fluctuate with the amount and timing of the settlement of these transactions.

We manage our cash, investments and capital structure so we are able to meet the short-term and long-term obligations of our business while maintaining financial flexibility and liquidity. We forecast, analyze and monitor our cash flows to enable investment and financing within the overall constraints of our financial strategy.

At June 30, 2012, our consolidated cash and cash equivalents totaled \$64.1 million, representing an increase of \$416,000 as compared to December 31, 2011. Cash flows generated from operating activities totaled \$108.7 million for the six months ended June 30, 2012, representing a decrease of \$7.0 million compared to the six months ended June 30, 2011.

We have historically funded our working capital requirements, capital expenditures and investment in individual animal hospitals primarily from internally generated cash flows and we expect to continue to do so in the future. During the first quarter of the 2012 fiscal year, we amended our Amended and Restated Credit & Guaranty Agreement, dated as of August 16, 2011. The First Amendment replenishes the aggregate amount of New Term Loan Commitments available under the Credit Agreement to a maximum of \$100 million, after giving effect to the funding of \$50 million of New Term Loan Commitments on January 24, 2012, which were drawn in connection with the additional investment made in AVC. As of June 30, 2012, we have access to an unused \$125 million revolving credit facility, which expires August 2016, allowing us to maintain further operating and financial flexibility.

Historically, we have been able to access the capital markets to fund acquisitions that could not be funded out of internally generated cash flows. The availability of financing in the form of debt or equity, however, is influenced by many factors including our profitability, operating cash flows, debt levels, debt ratings, contractual restrictions, and market conditions. Although in the past we have been able to obtain financing for material transactions on terms we believe to be reasonable, there is a possibility that we may not be able to obtain financing on favorable terms in the future.

Future Cash Flows

Short-Term

Other than our larger acquisitions, we historically have funded our working capital requirements, capital expenditures and investments in animal hospital acquisitions from internally generated cash flows. We anticipate that our cash on hand, net cash provided by operations, available funds under our revolving credit agreement and incremental facilities will be sufficient to meet our anticipated cash requirements for the next 12 months. If we consummate significant acquisitions of animal hospital chains or other businesses during this period, we may seek additional debt or equity financing.

For the year ended December 31, 2012, we expect to spend \$90 million to \$120 million for the acquisition of independent animal hospitals. The ultimate number of acquisitions and cash used is largely dependent upon the attractiveness of the candidates and the strategic fit within our operations. From January 1, 2012 to June 30, 2012, we spent \$19.2 million in connection with the acquisition of 14 independent animal hospitals, as well as, \$74.8 million for the acquisition of AVC and approximately \$7.5 million, net of acquired cash, for the acquisition of ThinkPets. In addition, we expect to spend approximately \$80 million in 2012 for both property and equipment additions and capital costs necessary to maintain our existing facilities, of which approximately \$37.2 million had been expended at June 30, 2012.

Long-Term

Our long-term liquidity needs, other than those related to the day-to-day operations of our business, including commitments for operating leases, generally comprises scheduled principal and interest payments for our outstanding long-term indebtedness, capital expenditures related to the expansion of our business, and acquisitions in accordance with our growth strategy.

We are unable to project with certainty whether our long-term cash flow from operations will be sufficient to repay our long-term debt when it comes due. If this cash flow is insufficient, we expect that we will need to refinance such

indebtedness, amend its terms to extend maturity dates, or issue common stock of our company. Our management cannot make any assurances that such refinancing, amendments or equity offerings, if necessary, will be available on attractive terms, if at all.

Debt Related Covenants

Our senior credit facility contains certain financial covenants pertaining to fixed-charge coverage and leverage ratios. In addition, the senior credit facility has restrictions pertaining to capital expenditures, acquisitions and the payment of cash

dividends. As of June 30, 2012, we were in compliance with these covenants, including the two covenant ratios, the fixed-charge coverage ratio and the leverage ratio.

At June 30, 2012, we had a fixed-charge coverage ratio of 1.63 to 1.00, which was in compliance with the required ratio of no less than 1.20 to 1.00. The senior credit facility defines the fixed-charge coverage ratio as that ratio that is calculated on a last 12-month basis by dividing pro forma earnings before interest, taxes, depreciation and amortization, as defined by the senior credit facility (“pro forma earnings”), by fixed charges. Fixed charges are defined as cash interest expense, scheduled principal payments on debt obligations, capital expenditures, and provision for income taxes. Pro forma earnings include 12 months of operating results for businesses acquired during the period. At June 30, 2012, we had a leverage ratio of 2.18 to 1.00, which was in compliance with the required ratio of no more than 3.00 to 1.00. The senior credit facility defines the leverage ratio as that ratio which is calculated as total debt divided by pro forma earnings.

Historical Cash Flows

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

| | Six Months Ended | |
|---|------------------|-----------|
| | June 30, | |
| | 2012 | 2011 |
| Cash provided by (used in): | | |
| Operating activities | \$108,668 | \$115,620 |
| Investing activities | (112,860) | (42,491) |
| Financing activities | 4,636 | (14,625) |
| Effect of currency exchange rate changes on cash and cash equivalents | (28) | 153 |
| Increase in cash and cash equivalents | 416 | 58,657 |
| Cash and cash equivalents at beginning of period | 63,651 | 97,126 |
| Cash and cash equivalents at end of period | \$64,067 | \$155,783 |
| Cash Flows from Operating Activities | | |

Net cash provided by operating activities decreased \$7.0 million in the six months ended June 30, 2012, as compared to the prior-year period. Operating cash flow for the six months ended June 30, 2012 included \$72.1 million of net income, net non-cash expenses of \$52.5 million and net cash used as a result of changes in operating assets and liabilities of \$15.9 million. The changes in operating assets and liabilities included a \$6.9 million increase in accounts receivable, a \$5.8 million increase in inventory, prepaid expenses and other assets, a \$1.8 million decrease in accounts payable and accrued liabilities, a \$2.5 million increase in prepaid income taxes, partially offset by a \$1.1 million increase in accrued payroll and related liabilities. The increase in accounts receivable was primarily due to an increase in net revenue. The increase in inventory, prepaid expenses and other assets was primarily a result of an increase in lease receivables, as a result of entering into additional contracts with clients. The decrease in accounts payable and accrued liabilities, the increase in prepaid income taxes and the increase in accrued payroll and related liabilities were all a result of timing of payment obligations.

Cash provided by operating activities of \$115.6 million for the six months ended June 30, 2011 consisted of \$70.6 million of net income, net non-cash expenses of \$42.1 million and net cash provided, as a result of changes in operating assets and liabilities of \$2.9 million. The changes in operating assets and liabilities primarily included a \$16.0 million increase in accrued payroll and related liabilities, and a \$7.9 million decrease in prepaid income taxes, offset by a \$8.0 million decrease in accounts payable and accrued liabilities, a \$7.8 million increase in trade accounts receivable and a \$5.2 million increase in inventory, prepaid expenses and other assets. The increase in accrued payroll and related liabilities, the decrease in prepaid income taxes and the decrease in accounts payable and accrued liabilities were all a result of timing of payment obligations. The increase in trade accounts receivable was primarily due to an increase in net revenue.

Cash Flows from Investing Activities

The table below presents the components of the changes in investing cash flows (in thousands):

| | Six Months Ended | | |
|--|------------------|-------------|---------------------------|
| | June 30, | | |
| Investing Cash Flows: | 2012 | 2011 | Variance |
| Acquisition of independent animal hospitals and laboratories | \$(19,193) | \$(11,600) | \$(7,593) ⁽¹⁾ |
| Acquisition of AVC | (48,891) | — | (48,891) |
| Acquisition of ThinkPets | (7,468) | — | (7,468) |
| Other | (276) | (204) | (72) |
| Total cash used for acquisitions | (75,828) | (11,804) | (64,024) |
| Property and equipment additions | (37,165) | (28,434) | (8,731) ⁽²⁾ |
| Real estate acquired with acquisitions | — | (1,900) | 1,900 |
| Proceeds from sale of assets | 78 | 140 | (62) |
| Other | 55 | (493) | 548 |
| Net cash used in investing activities | \$(112,860) | \$(42,491) | \$(70,369) |

(1) The number of acquisitions will vary from year to year based upon the available pool of suitable candidates. A discussion of our acquisitions is provided above in our Executive Overview.

(2) The cash used to acquire property and equipment will vary from period to period based on upgrade requirements and expansion of our animal hospital and laboratory facilities.

Cash Flows from Financing Activities

The table below presents the components of the changes in financing cash flows (in thousands):

| | Six Months Ended | | |
|---|------------------|-------------|----------------------------|
| | June 30, | | |
| Financing Cash Flows: | 2012 | 2011 | Variance |
| Repayment of debt | \$(43,318) | \$(14,164) | \$(29,154) ⁽¹⁾ |
| Proceeds from issuance of long-term debt | 50,000 | — | 50,000 ⁽²⁾ |
| Proceeds from revolving credit facility | 50,000 | — | 50,000 ⁽³⁾ |
| Repayment of revolving credit facility | (50,000) | — | (50,000) ⁽³⁾ |
| Payment of financing costs | (122) | — | (122) |
| Distributions to noncontrolling interest partners | (1,631) | (1,141) | (490) |
| Proceeds from issuance of common stock under stock option plans | 2,885 | 2,456 | 429 |
| Excess tax benefit from exercise of stock options | 248 | 906 | (658) |
| Stock repurchases | (2,770) | (2,337) | (433) ⁽⁴⁾ |
| Other | (656) | (345) | (311) |
| Net cash provided by (used in) financing activities | \$4,636 | \$(14,625) | \$19,261 |

(1) For the six months ended June 30, 2012, we paid \$25.9 million to pay off debt related to the acquisition of AVC. Additionally, we paid \$17.4 million in scheduled payments.

The proceeds from issuance of long term debt for the six months ended June 30, 2012 included \$50 million of new term loans borrowed pursuant to our incremental facilities permitted under our August 16, 2011 credit and guaranty agreement, which were used to fund the AVC acquisition.

(2) For the six months ended June 30, 2012 we borrowed against our revolving credit facility to fund the AVC acquisition, which was subsequently repaid with the proceeds from the issuance of \$50 million of new term loans, as mentioned above.

- (4) The stock repurchases represent cash paid for income taxes on behalf of employees who elected to settle their tax obligations on vested stocks with a portion of the stocks that vested.

Future Contractual Cash Requirements

The following table sets forth material changes from the amounts reported in our 2011 Form 10-K to our scheduled principal and interest obligations due by us for each of the years indicated as of June 30, 2012 (in thousands):

| | Payment due by period | | | |
|--|-----------------------|---------------------|--------------|--------------|
| | Total | Less than 1 year | 1-3 years | 3-5 years |
| Contractual Obligations: | | | | |
| Long-term debt | \$608,203 | \$31,563 | \$90,742 | \$485,898 |
| Variable cash interest expense Term A ⁽¹⁾ | 43,892 | 11,927 | 21,547 | 10,418 |
| | \$652,095 | \$43,490 | \$112,289 | \$496,316 |

- (1) The interest payments on our variable-rate senior term notes are based on rates effective as of June 30, 2012.

Off-Balance-Sheet Financing Arrangements

Other than operating leases, as of June 30, 2012, we do not have any off-balance-sheet financing arrangements.

Description of Indebtedness

Senior Credit Facility

At June 30, 2012, we had \$608.2 million principal outstanding under our senior term notes and no borrowings outstanding under our \$125 million revolving credit facility.

We pay interest on our senior term notes and revolving credit facility based on the interest rate offered to our administrative agent on the adjusted Eurodollar rate plus a margin determined by reference to the leverage ratio in effect from time to time as set forth in the table in Note 5, Long-Term Obligations, in our condensed, consolidated financial statements of this quarterly report on Form 10-Q, which ranges from 1.25% to 2.25% per annum. The senior term notes and the revolving credit facility mature in August 2016.

Other Debt and Capital Lease Obligations

At June 30, 2012, we had seller notes secured by assets of certain animal hospitals and capital leases that totaled \$40.0 million, which are included in long-term debt in our condensed, consolidated balance sheet of this quarterly report on Form 10-Q. Our seller notes have various maturities through 2013 and various interest rates ranging from 9.0% to 10.0%. Our capital leases have various maturities through 2030 and various interest rates ranging from 1.4% to 9.6%.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At June 30, 2012, we had borrowings of \$608.2 million under our senior credit facility with fluctuating interest rates based on market benchmarks such as the adjusted Eurodollar rate. Changes in interest rates could adversely affect the market value of our variable-rate debt. If the adjusted Eurodollar rate increases or decreases 1% from June 30, 2012, the additional annual interest expense or savings will amount to \$6.0 million. This represents an increase of approximately \$400,000 in both additional interest payments and interest savings, in comparison to our estimate included in Item 7A of our 2011 Annual Report on Form 10-K, due to the issuance of \$50 million in additional senior term notes.

ITEM 4. CONTROLS AND PROCEDURES

We carried out an evaluation required by the Exchange Act, under the supervision and with the participation of our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, as of the end of the period covered by this report. Based on this evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

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

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur, or that all control issues and instances of fraud, if any, within the company have been detected.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those disclosed in Part I, Item 1A, of our 2011 Annual Report on Form 10-K.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

The agreements and other documents filed as exhibits to this report are not intended to provide factual information or other disclosure, other than with respect to the terms of the agreements or other documents themselves, and you should not rely on them for that purpose. In particular, any representations and warranties made by us in these agreements or other documents were made solely within the specific context of the relevant agreement or document and may not describe the actual state of affairs as of the date they were made or at any other time.

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

101.INS XBRL Instance Document*

101.SCH XBRL Taxonomy Extension Schema Document*

101.CAL XBRL Taxonomy Extension Calculation Linkbase*

101.DEF XBRL Taxonomy Definition Linkbase*

101.LAB XBRL Taxonomy Extension Label Linkbase*

101.PRE XBRL Taxonomy Extension Presentation Linkbase*

* Furnished, not filed.

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on August 9, 2012.

Date: August 9, 2012

By: /s/ Tomas W. Fuller
Tomas W. Fuller
Chief Financial Officer, Principal
Accounting Officer, and Vice President
and Secretary

EXHIBIT INDEX

| Exhibit No. | Description |
|-------------|---|
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

Exhibit 101.INS XBRL Instance Document*

Exhibit 101.SCH XBRL Extension Schema Document*

Exhibit 101.CAL XBRL Extension Calculation Linkbase Document*

Exhibit 101.LAB XBRL Extension Label Linkbase Document*

Exhibit 101.PRE XBRL Extension Presentation Linkbase Document*

Exhibit 101.DEF XBRL Extension Definition Linkbase Document*

*Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be “filed” for purposes of Section 18 of the Exchange Act of 1934, as amended (“Exchange Act”), or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as may be expressly set forth by specific reference in such filings.