VCA ANTECH INC
Form 10-Q
November 05, 2004

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

FORM 10-Q

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

For the quarterly period ended September 30, 2004

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

Commission File Number: 001-16783

VCA ANTECH, INC.

(Exact name of registrant as specified in its charter)

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

12401 West Olympic Boulevard
Los Angeles, California 90064-1022
(Address of principal executive offices)

(310) 571-6500
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [X] 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 82,054,302 shares as of November 3, 2004.

VCA ANTECH, INC.
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SEPTEMBER 30, 2004

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VCA ANTECH, INC. AND SUBSIDIARIES

CONDENSED, CONSOLIDATED BALANCE SHEETS
As of September 30, 2004 and December 31, 2003
(Unaudited)
(In thousands, except par value)

	September 30, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 50,834	$ 17,237
Trade accounts receivable, less allowance for uncollectible accounts of $7,475 and $6,681 at September 30, 2004 and December 31, 2003, respectively	25,765	22,335
Inventory, prepaid expenses and other	11,138	9,432
Deferred income taxes	12,921	11,040
Prepaid income taxes	8,368	7,266
Total current assets	109,026	67,310
Property and equipment, net	114,983	99,161
Other assets:		
Goodwill	481,076	373,238
Other intangible assets, net	7,716	4,692
Deferred financing costs, net	4,037	4,601
Other	6,900	5,801
Total assets	$ 723,738	$ 554,803
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term obligations	$ 3,613	$ 2,403
Accounts payable	12,611	9,208
Accrued payroll and related liabilities	20,119	15,716
Accrued interest	5,762	1,538
Other accrued liabilities	18,356	15,006
Total current liabilities	60,461	43,871

Long-term obligations, less current portion	394,041	315,066
Deferred income taxes	30,485	24,532
Other liabilities	11,223	5,392
Minority interest	9,197	4,019
Preferred stock, par value $0.001, 11,000 shares authorized, none outstanding		
Stockholders equity:		
Common stock, par value $0.001, 175,000 shares authorized, and 82,008 and 81,430 shares outstanding as of September 30, 2004 and December 31, 2003, respectively	82	81
Additional paid-in capital	250,174	244,271
Accumulated deficit	(32,076)	(82,331)
Accumulated other comprehensive income (loss)	161	(82)
Notes receivable from stockholders	(10)	(16)
Total stockholders equity	218,331	161,923
Total liabilities and stockholders equity	$ 723,738	$ 554,803

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

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VCA ANTECH, INC. AND SUBSIDIARIES

CONDENSED, CONSOLIDATED INCOME STATEMENTS
For the Three and Nine Months Ended September 30, 2004 and 2003
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
		(Restated)		(Restated)
Revenue	$183,352	$143,884	$497,649	$412,224
Direct costs	133,571	102,848	358,304	295,414
Gross profit	49,781	41,036	139,345	116,810
Selling, general and administrative	13,037	9,353	33,503	28,546
Write-down and loss (gain) on sale of assets	(12)	442	54	282
Operating income	36,756	31,241	105,788	87,982
Interest expense, net	6,629	6,361	18,712	19,771
Minority interest expense	746	456	1,917	1,279
Debt retirement costs		1,701	810	9,118
Other (income) expense	(9)	(129)	(185)	129
Income before provision for income taxes	29,390	22,852	84,534	57,685
Provision for income taxes	12,046	9,363	34,279	23,663
Net income	$ 17,344	$ 13,489	$ 50,255	$ 34,022
Basic earnings per common share	$ 0.21	$ 0.17	$ 0.62	$ 0.42
Diluted earnings per common share	$ 0.21	$ 0.16	$ 0.60	$ 0.42
Shares used for computing basic earnings per share	81,944	81,282	81,701	80,190
Shares used for computing diluted earnings per share	83,455	82,668	83,300	81,300

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

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VCA ANTECH, INC. AND SUBSIDIARIES

CONDENSED, CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Months Ended September 30, 2004 and 2003
(Unaudited)
(In thousands)

	Nine Months Ended September 30,	
	2004	**2003**
Cash flows from operating activities:		
Net income	$ 50,255	$ 34,022
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,407	10,653
Amortization of deferred financing costs and debt discount	552	669
Provision for uncollectible accounts	2,190	2,371
Debt retirement costs	810	9,118
Write-down of assets		392
Loss (gain) on sale of assets	54	(110)
Other	(350)	
Minority interest in income of subsidiaries	1,917	1,279
Distributions to minority interest partners	(1,505)	(1,245)
Increase in trade accounts receivable	(5,075)	(4,399)
Increase in inventory, prepaid expenses and other assets	(909)	(438)
Increase (decrease) in accounts payable and other accrued liabilities	1,759	(552)
Increase (decrease) in accrued payroll and related liabilities	(677)	1,121
Increase in accrued interest	4,107	4,192
Decrease in prepaid income taxes	2,369	7,614
Increase in income taxes payable		1,232
Increase in deferred income tax assets	(823)	(2,169)
Increase in deferred income tax liabilities	5,654	3,940
Net cash provided by operating activities	71,735	67,690
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(97,152)	(27,177)
Real estate acquired in connection with business acquisitions	(5,565)	(589)
Property and equipment additions	(16,035)	(11,040)
Proceeds from sale of assets	184	363
Other	1,553	447
Net cash used in investing activities	(117,015)	(37,996)

Cash flows from financing activities:		
Repayment of long-term obligations, including redemption fees	(147,691)	(209,992)
Proceeds from the issuance of long-term debt	225,000	146,442
Repayment of revolving credit facility		(7,500)
Payment of financing costs	(794)	(1,069)
Proceeds from issuance of common stock under stock option plans	2,362	85
Proceeds from issuance of common stock		54,323
Net cash provided by (used in) financing activities	78,877	(17,711)
Increase in cash and cash equivalents	33,597	11,983
Cash and cash equivalents at beginning of period	17,237	6,462
Cash and cash equivalents at end of period	$ 50,834	$ 18,445

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

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VCA ANTECH, INC. AND SUBSIDIARIES

NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2004
(Unaudited)

1. General

The accompanying unaudited condensed, consolidated financial statements of VCA Antech, Inc. and subsidiaries (the Company or VCA) 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. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements as permitted under applicable rules and regulations. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. The results of operations for the three and nine months ended September 30, 2004 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the Company s consolidated financial statements and footnotes thereto included in the Company s 2003 Annual Report on Form 10-K.

2. Acquisitions

National PetCare Centers, Inc.

On June 1, 2004, the Company consummated a merger with National PetCare Centers, Inc. (NPC), which operated 67 animal hospitals located in 11 states as of the merger date. As of September 30, 2004, the Company had not finalized the purchase price accounting for the transaction. The total consideration as of September 30, 2004 was $91.5 million, consisting of $66.2 million in cash (net of cash acquired) paid to holders of NPC stock and debt; $2.5 million in assumed debt; $12.8 million in assumed liabilities; $5.9 million of assumed operating leases whose terms were in excess of market; $2.0 million paid for professional and other outside services; and $2.1 million as part of the Company s plan to close certain facilities and terminate certain employees. The preliminary allocation for the $91.5 million is as follows: $12.1 million to tangible assets, $77.9 million to goodwill and $1.4 million to other intangible assets. The amounts of the allocation will change primarily due to the Company determining the costs related to its integration plan. The Company expects that approximately $18.6 million of the goodwill for NPC will be fully deductible for income tax purposes.

As part of its integration plan, the Company has closed NPC s corporate office and intends to close or sell animal hospitals that do not meet its operating model and eliminate NPC s employees with duplicative functions. The Company has commenced these activities but, as of September 30, 2004, had not yet determined the total related costs. Costs incurred in connection with the integration plan, consisting primarily of lease termination costs and employee severance costs, will result in additions to the total purchase price of the transaction.

During the three and nine months ended September 30, 2004, the Company incurred other integration costs of $668,000 and $1.2 million, respectively, reported as a component of selling, general and administrative expense on its income statements.

Total Acquisition Activity

The following table summarizes the number of acquired animal hospitals and veterinary diagnostic laboratories (including the NPC acquisition on June 1, 2004):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Laboratories:				
Acquisitions		1		7
Acquisitions relocated into the Company s laboratories	—	(1)	—	(3)
	—	—	—	4
Animal hospitals:				
Acquisitions	2	3	84	19
Acquisitions relocated into the Company s animal hospitals	(1)	—	(4)	(5)
	1	3	80	14

The following table summarizes the preliminary aggregate consideration, including acquisition costs, paid by the Company for its acquisitions (including the NPC merger on June 1, 2004) and the preliminary allocation of the purchase price (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Consideration:				
Cash	$1,554	$6,775	$ 95,739	$26,130
Obligation to be settled in cash or common stock				2,250
Obligations to sellers (1)	100	300	1,235	982
Notes payable and other liabilities assumed	71	30	21,858	1,145

Total	$1,725	$7,105	$118,832	$30,507
Purchase Price Allocation (2):				
Tangible assets	$ 103	$ 335	$ 13,037	$ 2,558
Identifiable intangible assets	121	453	3,069	1,658
Goodwill	1,501	6,317	102,726	26,291
Total	$1,725	$7,105	$118,832	$30,507

(1) Represents a portion of the purchase price withheld (the holdback) as security for indemnification obligations of the sellers under the acquisition agreement. The unused portion is paid to the seller after a designated period following the date of acquisition.

(2) Represents preliminary purchase price allocations subject to change in accordance with GAAP.

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The following table summarizes goodwill assigned to the laboratory and animal hospital segments (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Laboratory	$	$ 905	$	$ 7,198
Animal hospital	1,501	5,412	102,726	19,093
	1,501	6,317	102,726	26,291
Purchase price allocation adjustments	1,842	40	215	149
Total (1)	$3,343	$6,357	$102,941	$26,440

(1) The Company expects that $1.8 million and $4.5 million of the goodwill recorded for the three months ended September 30, 2004 and 2003, respectively, and $40.2 million and $15.5 million of the goodwill recorded for the nine months ended September 30, 2004 and 2003, respectively, will be fully deductible for income tax purposes.

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Partnership Interests

During the nine months ended September 30, 2004, the Company purchased the ownership interests of partners in six partially-owned subsidiaries of the Company; two of those interests were purchased during the third quarter of 2004. During the nine months ended September 30, 2003, the Company purchased the total ownership interest of partners in three partially-owned subsidiaries of the Company; one of those interests was purchased during the third quarter of 2003. The following table summarizes the consideration paid by the Company and the amount of goodwill recorded (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Consideration:				
Cash	$ 616	$ 138	$ 922	$ 244
Notes receivable (1)			184	41
Notes payable and other liabilities assumed	90		221	763
Total	$ 706	$ 138	$1,327	$1,048
Goodwill recorded (2)	$ 236	$	$ 846	$ 295

(1) The Company forgave certain notes owed to the Company by the partner.

(2) The Company expects that the goodwill recorded for the transactions will be fully deductible for income tax purposes.

Other Acquisition Payments

During the nine months ended September 30, 2004 and 2003, the Company paid $864,000 and $745,000 respectively, of unused holdbacks to sellers in previously closed acquisitions.

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

3. Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to identifiable assets acquired and liabilities assumed. Other intangible assets represent non-contractual customer relationships for veterinary diagnostic laboratories, covenants-not-to-compete and client lists, all of which are associated with acquisitions.

The following table presents the changes in the carrying amount of goodwill for the nine months ended September 30, 2004 (in thousands):

	Laboratory	Animal Hospital	Total
Balance as of January 1, 2004	$94,770	$278,468	$373,238
Goodwill acquired		102,726	102,726
Purchase price allocation adjustments	(1,084)	1,299	215
Goodwill related to partnerships		4,917	4,917
Goodwill written-off related to sale of animal hospital		(20)	(20)
Balance as of September 30, 2004	$93,686	$387,390	$481,076

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In addition to goodwill, the Company had amortizable other intangible assets as follows (in thousands):

	As of September 30, 2004			As of December 31, 2003		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Non-contractual customer relationships	$ 1,530	$ (100)	$1,430	$	$	$
Covenants-not-to-compete	13,041	(6,929)	6,112	10,141	(5,515)	4,626
Client lists	668	(494)	174	498	(432)	66
Total	$15,239	$(7,523)	$7,716	$10,639	$(5,947)	$4,692

The aggregate amortization related to other intangible assets was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Aggregate amortization expense	$ 583	$ 476	$1,576	$1,391

Based on balances at September 30, 2004, estimated annual amortization expense for other intangible assets for the current year and the next four fiscal years is as follows (in thousands):

2004	$2,143
2005	$1,932
2006	$1,575
2007	$1,338
2008	$ 923

4. Calculation of Earnings per Common Share

Basic and diluted earnings per common share were computed as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Net income	$17,344	$13,489	$50,255	$34,022
Weighted average common shares outstanding:				
Basic	81,944	81,282	81,701	80,190
Effect of dilutive common shares:				
Stock options	1,511	1,178	1,526	1,016
Contracts that may be settled in stock or cash		208	73	94
Diluted	83,455	82,668	83,300	81,300
Basic earnings per common share	$ 0.21	$ 0.17	$ 0.62	$ 0.42
Diluted earnings per common share	$ 0.21	$ 0.16	$ 0.60	$ 0.42

5. Common Stock

On July 13, 2004, the Company amended its Amended and Restated Certificate of Incorporation to increase the number of shares of common stock the Company is authorized to issue from 75.0 million to 175.0 million.

On August 25, 2004, the Company effected a two-for-one stock split in the form of a 100% stock dividend payable to stockholders of record as of August 11, 2004. All share and per share information included in this document have been restated to reflect the effect of the stock dividend.

6. Interest-Rate Hedging Agreements

The Company has entered into no-fee swap agreements (Swap Agreements), whereby the Company pays to counterparties amounts based on fixed interest rates and set notional amounts in exchange for the receipt of payments from counterparties based on LIBOR and the same set notional principal amounts. A summary of these agreements is as follows:

	Swap #1	Swap #2	Swap #3
Fixed interest rate	2.22%	1.72%	1.51%
Notional amount	$40.0 million	$20.0 million	$20.0 million
Effective date	11/29/2002	5/30/2003	5/30/2003
Expiration date	11/29/2004	5/31/2005	5/31/2005
Counter party	Wells Fargo Bank	Wells Fargo Bank	Goldman Sachs
Qualifies for hedge accounting (1)	No	No	Yes

(1) Swap #1 and #2 were no longer considered effective as of May 2003 and March 2004, respectively.

Both Swap #1 and Swap #2 were initially considered to be cash-flow hedging instruments; however, management has determined that they are no longer effective tools for mitigating interest-rate risk within an acceptable degree of variance because the current interest rate environment is materially different than management s projections at the inception of the contracts. As a result of this determination, Swap #1 and Swap #2 no longer qualify for hedge accounting and all changes in their market value are recognized as income or expense in the period of change with the fair market value reflected as an asset or liability on the balance sheet.

The following table summarizes the Company s payments and unrealized loss (gain) recognized under the Swap Agreements (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Cash paid (1)	$90	$ 165	$ 419	$352
Unrealized loss (gain) (2)	$ (9)	$(129)	$(185)	$129

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

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

The valuations of the Swap Agreements are determined by the counterparties based on fair market valuations for similar agreements. The fair market value of the Swap Agreements resulted in an asset of $151,000 and a liability of $277,000 at September 30, 2004 and December 31, 2003, respectively, from the interest rate hedging activities.

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7. Consolidation of Variable Interest Entities

Under the provisions of Financial Accounting Standards Board Interpretation No. 46R (FIN No. 46R), *Consolidation of Variable Interest Entities*, adopted by the Company in the fourth quarter of 2003, the veterinary medical groups for which the Company provides management services are variable interest entities. As a result of adopting FIN No. 46R, the Company consolidated the veterinary medical groups. The prior periods presented have been restated to conform to the current period presentation. The restatement resulted in an increase in both revenue and direct costs in the amount of $11.0 million and $31.0 million for the three and nine months ended September 30, 2003, respectively, thus there was no impact on gross profit, operating income, net income, earnings per share or cash flows.

8. Lines of Business

During the three and nine months ended September 30, 2004 and 2003, the Company had three reportable segments: Laboratory, Animal Hospital and Corporate. These segments are strategic business units that have different products, services and functions. The segments are managed separately because each is a distinct and different business venture with unique challenges, rewards and risks. The Laboratory segment provides testing services for veterinarians both associated with the Company and independent of the Company. The Animal Hospital segment provides veterinary services for companion animals and sells related retail and pharmaceutical products. Corporate provides selling, general and administrative support for the other two segments.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies as detailed in the Company s consolidated financial statements and footnotes thereto included in the 2003 Annual Report on Form 10-K. The Company evaluates performance of segments based on operating income. For purposes of reviewing the operating performance of the segments, all intercompany sales and purchases are accounted for as if they were transactions with independent third parties at current market prices.

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

	Laboratory	Animal Hospital	Corporate	Intercompany Eliminations	Total
Three Months Ended September 30, 2004					
Revenue	$ 50,685	$136,399	$	$(3,732)	$183,352
Direct costs	28,470	108,833		(3,732)	133,571
Gross profit	22,215	27,566			49,781
Selling, general and administrative	3,136	3,423	6,478		13,037
Gain on sale of assets		(12)			(12)
Operating income (loss)	$ 19,079	$ 24,155	$ (6,478)	$	$ 36,756
Depreciation and amortization	$ 850	$ 2,722	$ 400	$	$ 3,972
Capital expenditures	$ 2,108	$ 4,451	$ 449	$	$ 7,008
Three Months Ended September 30, 2003					
Revenue	$ 46,429	$100,060	$	$(2,605)	$143,884
Direct costs	26,664	78,789		(2,605)	102,848
Gross profit	19,765	21,271			41,036
Selling, general and administrative	2,855	2,516	3,982		9,353
Write-down and loss on sale of assets	39	403			442
Operating income (loss)	$ 16,871	$ 18,352	$ (3,982)	$	$ 31,241
Depreciation and amortization	$ 823	$ 2,387	$ 369	$	$ 3,579
Capital expenditures	$ 621	$ 3,900	$ 351	$	$ 4,872

Nine Months Ended September 30, 2004					
Revenue	$151,818	$355,739	$	$(9,908)	$497,649
Direct costs	84,168	284,044		(9,908)	358,304
Gross profit	67,650	71,695			139,345
Selling, general and administrative	9,499	9,227	14,777		33,503
Loss on sale of assets	1	53			54
Operating income (loss)	$ 58,150	$ 62,415	$(14,777)	$	$105,788
Depreciation and amortization	$ 2,568	$ 7,659	$ 1,180	$	$ 11,407
Capital expenditures	$ 3,911	$ 10,982	$ 1,142	$	$ 16,035
Nine Months Ended September 30, 2003					
Revenue	$134,818	$285,189	$	$(7,783)	$412,224
Direct costs	76,489	226,708		(7,783)	295,414
Gross profit	58,329	58,481			116,810
Selling, general and administrative	8,359	7,538	12,649		28,546
Write-down and loss (gain) on sale of assets	58	225	(1)		282
Operating income (loss)	$ 49,912	$ 50,718	$(12,648)	$	$ 87,982
Depreciation and amortization	$ 2,376	$ 7,168	$ 1,109	$	$ 10,653
Capital expenditures	$ 2,385	$ 7,258	$ 1,397	$	$ 11,040

	Laboratory	Animal Hospital	Corporate	Intercompany Eliminations	Total
At September 30, 2004					
Total assets	$135,207	$502,682	$85,849	$ —	$723,738
At December 31, 2003					
Total assets	$130,799	$374,940	$49,064	$ —	$554,803

Below is a reconciliation between total segment operating income after eliminations and consolidated income before provision for income taxes as reported on the condensed, consolidated income statements (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Total segment operating income after eliminations	$36,756	$31,241	$105,788	$87,982
Interest expense, net	6,629	6,361	18,712	19,771
Debt retirement costs		1,701	810	9,118
Other (income) expense	(9)	(129)	(185)	129
Minority interest expense	746	456	1,917	1,279
Income before provision for income taxes	$29,390	$22,852	$ 84,534	$57,685

9. Financing Transactions

On June 1, 2004, the Company amended and restated its Credit and Guaranty Agreement to replace its existing senior term D notes in the principal amount of $145.3 million with an interest rate margin of 2.50% with new senior term E notes in the principal amount of $225.0 million with an interest rate margin of 2.25%. The Company used the additional borrowings to fund the NPC merger as detailed above in Footnote 2. Acquisitions and plans to use the remaining borrowings for related merger costs and general corporate purposes. The Company incurred debt retirement costs of $810,000 as a result of amending and restating its Credit and Guaranty Agreement. These debt retirement costs consisted of $142,000 for the write-off of existing deferred financing costs related to the senior term D notes and $668,000 for costs incurred related to the new senior term E notes.

In August 2003, the Company refinanced its Credit and Guaranty Agreement to replace its existing senior term C notes in the principal amount of $166.4 million with an interest rate margin of 3.00% with $20.0 million of cash on-hand and new senior term D notes in the principal amount of $146.4 million with an interest rate margin of 2.50%. In conjunction with that transaction, the Company recorded debt retirement costs of $1.7 million.

In February 2003, the Company sold 3.8 million shares of its common stock in exchange for net proceeds of $54.3 million. The Company used $42.7 million of the net proceeds to voluntarily retire the remaining principal amount outstanding of its 15.5% senior notes due 2010 at a price of 110% of the principal amount plus accrued and unpaid interest. As a result of the debt retirement the Company incurred debt retirement costs of $7.4 million.

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10. Stock-Based Compensation

The Company has granted stock options to various employees under multiple stock option plans and is accounting for those options under the intrinsic value method as prescribed in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. Under that method, when options are issued with a strike price equal to or greater than market price on date of issuance, there is no impact on earnings either on the date of issuance or thereafter, absent modification to the options. This method is not a fair-value-based method of accounting as defined by Statements of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*. Fair-value-based methods of accounting require compensation expense to be recognized based on the fair market value of the options granted over their vesting period. The following table presents net income and earnings per common share for the three and nine months ended September 30, 2004 and 2003 as if the Company accounted for its stock options under SFAS No. 123 and the fair-value-based method of accounting (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
As reported	$17,344	$13,489	$50,255	$34,022
Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects	(484)	(216)	(1,246)	(644)
Pro forma net income available to common stockholders	$16,860	$13,273	$49,009	$33,378
Earnings per common share:				
Basic as reported	$ 0.21	$ 0.17	$ 0.62	$ 0.42
Basic pro forma	$ 0.21	$ 0.16	$ 0.60	$ 0.42
Diluted as reported	$ 0.21	$ 0.16	$ 0.60	$ 0.42
Diluted pro forma	$ 0.20	$ 0.16	$ 0.59	$ 0.41

11. Reclassifications

Certain 2003 balances have been reclassified to conform to the 2004 financial statement presentation. The most significant of these changes was the reclassification of depreciation and amortization into direct costs and selling, general and administrative expense.

12. Condensed, Consolidating Information

The Company has a legal structure comprised of a holding company and an operating company. VCA is the holding company. Vicar Operating, Inc. (Vicar) is the operating company and wholly-owned by VCA. Vicar owns the capital stock of all of the Company s subsidiaries.

In connection with Vicar s issuance in November 2001 of $170.0 million of 9.875% senior subordinated notes, VCA and each existing and future domestic wholly-owned restricted subsidiary of Vicar (the Guarantor Subsidiaries) have, jointly and severally, fully and unconditionally guaranteed the 9.875% senior subordinated notes. These guarantees are unsecured and subordinated in right of payment to all existing and future indebtedness outstanding under the Credit and Guaranty Agreement and any other indebtedness permitted to be incurred by Vicar under the terms of the indenture agreement for the 9.875% senior subordinated notes.

Vicar s subsidiaries are composed of wholly-owned restricted subsidiaries and partnerships. The partnerships may elect to serve as guarantors of Vicar s obligations, however, none of the partnerships have elected to do so (the Non-Guarantor Subsidiaries). Vicar conducts all of its business through and derives virtually all of its income from its subsidiaries. Therefore, Vicar s ability to make required payments with respect to its indebtedness (including the 9.875% senior subordinated notes) and other obligations depends on the financial results and condition of its subsidiaries and its ability to receive funds from its subsidiaries.

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Pursuant to Rule 3-10 of Regulation S-X, the following condensed, consolidating information is for VCA, Vicar, the Guarantor Subsidiaries and the Non-Guarantor Subsidiaries with respect to the 9.875% senior subordinated notes. This condensed financial information has been prepared from the books and records maintained by VCA, Vicar, the Guarantor Subsidiaries and the Non-Guarantor Subsidiaries. The condensed financial information may not necessarily be indicative of results of operations or financial position had the Guarantor Subsidiaries and the Non-Guarantor Subsidiaries operated as independent entities. The separate financial statements of the Guarantor Subsidiaries are not presented because management has determined they would not be material to investors.

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VCA ANTECH, INC. AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED, CONSOLIDATING BALANCE SHEETS
As of September 30, 2004
(Unaudited)
(In thousands)

	VCA	Vicar	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimination	Consolidated
Current assets:						
Cash and cash equivalents	$	$ 48,390	$ 2,366	$ 78	$	$ 50,834
Trade accounts receivable, net		9	25,089	667		25,765
Inventory, prepaid expenses and other		3,729	6,715	694		11,138
Deferred income taxes		12,921				12,921
Prepaid income taxes		8,368				8,368
Total current assets		73,417	34,170	1,439		109,026
Property and equipment, net		6,404	106,130	2,449		114,983
Other assets:						
Goodwill			449,751	31,325		481,076
Other intangible assets, net			6,966	750		7,716
Deferred financing costs, net		4,037				4,037
Other	29	1,962	3,740	2,786	(1,617)	6,900
Investment in subsidiaries	253,638	386,786	32,435		(672,859)	
Total assets	$253,667	$ 472,606	$633,192	$38,749	$(674,476)	$723,738
Current liabilities:						
Current portion of long-term obligations	$	$ 2,522	$ 1,091	$ 202	$ (202)	$ 3,613
Accounts payable		9,960	2,651			12,611
Accrued payroll and related liabilities		12,284	7,454	381		20,119
Accrued interest		5,621	141			5,762
Other accrued liabilities		14,180	4,176			18,356
Total current liabilities		44,567	15,513	583	(202)	60,461
Long-term obligations, less current portion		393,214	2,242		(1,415)	394,041

Deferred income taxes		30,485				30,485
Other liabilities		3,544	7,679			11,223
Intercompany payable/(receivable)	35,336	(252,842)	220,972	(3,466)		
Minority interest					9,197	9,197
Preferred stock						
Stockholders equity:						
Common stock	82					82
Additional paid-in capital	250,174					250,174
Accumulated equity (deficit)	(32,076)	253,477	386,786	41,632	(681,895)	(32,076)
Accumulated other comprehensive income	161	161			(161)	161
Notes receivable from stockholders	(10)					(10)
Total stockholders equity	218,331	253,638	386,786	41,632	(682,056)	218,331
Total liabilities and stockholders equity	$253,667	$ 472,606	$633,192	$38,749	$(674,476)	$723,738

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VCA ANTECH, INC. AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED, CONSOLIDATING BALANCE SHEETS
As of December 31, 2003
(In thousands)

	VCA	Vicar	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimination	Consolidated
Current assets:						
Cash and cash equivalents	$	$ 14,883	$ 2,244	$ 110	$	$ 17,237
Trade accounts receivable, net		6	21,790	539		22,335
Inventory, prepaid expenses and other		2,607	6,228	597		9,432
Deferred income taxes		11,040				11,040
Prepaid income taxes		7,266				7,266
Total current assets		35,802	30,262	1,246		67,310
Property and equipment, net		6,692	90,933	1,536		99,161
Other assets:						
Goodwill			351,130	22,108		373,238
Other intangible assets, net			4,116	576		4,692
Deferred financing costs, net		4,601				4,601
Other	30	1,939	2,451	2,296	(915)	5,801
Investment in subsidiaries	203,141	313,565	25,109		(541,815)	
Total assets	$ 203,171	$ 362,599	$ 504,001	$ 27,762	$ (542,730)	$ 554,803
Current liabilities:						
Current portion of long-term obligations	$	$ 1,544	$ 859	$	$	$ 2,403
Accounts payable		7,295	1,913			9,208
Accrued payroll and related liabilities		7,837	7,541	338		15,716
Accrued interest		1,517	16	5		1,538
Other accrued liabilities		10,590	4,423	(7)		15,006
Total current liabilities		28,783	14,752	336		43,871
Long-term obligations, less current portion		314,451	1,530		(915)	315,066
Deferred income taxes		24,532				24,532

Other liabilities		3,216	2,176			5,392
Intercompany payable/(receivable)	41,248	(211,524)	171,978	(1,702)		
Minority interest					4,019	4,019
Preferred stock						
Stockholders equity:						
Common stock	81					81
Additional paid-in capital	244,271					244,271
Accumulated equity (deficit)	(82,331)	203,223	313,565	29,128	(545,916)	(82,331)
Accumulated other comprehensive loss	(82)	(82)			82	(82)
Notes receivable from stockholders	(16)					(16)
Total stockholders equity	161,923	203,141	313,565	29,128	(545,834)	161,923
Total liabilities and stockholders equity	$203,171	$ 362,599	$504,001	$27,762	$(542,730)	$554,803

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VCA ANTECH, INC. AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED, CONSOLIDATING INCOME STATEMENTS
For the Three Months Ended September 30, 2004
(Unaudited)
(In thousands)

	VCA	Vicar	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimination	Consolidated
Revenue	$	$	$168,974	$14,844	$ (466)	$183,352
Direct costs			122,450	11,587	(466)	133,571
Gross profit			46,524	3,257		49,781
Selling, general and administrative		6,478	6,050	509		13,037
Loss on sale of assets			(11)	(1)		(12)
Operating income (loss)		(6,478)	40,485	2,749		36,756
Interest expense, net		6,594	90	(55)		6,629
Minority interest expense					746	746
Other income		(9)				(9)
Equity interest in income of subsidiaries	17,344	28,407	2,058		(47,809)	
Income before provision (benefit) for income taxes	17,344	15,344	42,453	2,804	(48,555)	29,390
Provision (benefit) for income taxes		(2,000)	14,046			12,046
Net income	$17,344	$17,344	$ 28,407	$ 2,804	$(48,555)	$ 17,344

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VCA ANTECH, INC. AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED, CONSOLIDATING INCOME STATEMENTS
For the Three Months Ended September 30, 2003
(Unaudited)
(In thousands)

	VCA	Vicar	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimination	Consolidated
Revenue	$	$	$133,089	$11,044	$ (249)	$143,884
Direct costs			94,484	8,613	(249)	102,848
Gross profit			38,605	2,431		41,036
Selling, general and administrative		3,982	4,970	401		9,353
Write-down and loss on sale of assets			442			442
Operating income (loss)		(3,982)	33,193	2,030		31,241
Interest expense, net	(2)	6,354	38	(29)		6,361
Minority interest expense					456	456
Debt retirement costs		1,701				1,701
Other income		(129)				(129)
Equity interest in income of subsidiaries	13,488	20,541	1,603		(35,632)	
Income before provision (benefit) for income taxes	13,490	8,633	34,758	2,059	(36,088)	22,852
Provision (benefit) for income taxes	1	(4,855)	14,217			9,363
Net income	$13,489	$13,488	$ 20,541	$ 2,059	$(36,088)	$ 13,489

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VCA ANTECH, INC. AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED, CONSOLIDATING INCOME STATEMENTS
For the Nine Months Ended September 30, 2004
(Unaudited)
(In thousands)

	VCA	Vicar	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimination	Consolidated
Revenue	$	$	$458,552	$40,238	$ (1,141)	$497,649
Direct costs			327,928	31,517	(1,141)	358,304
Gross profit			130,624	8,721		139,345
Selling, general and administrative		14,777	17,313	1,413		33,503
Loss (gain) on sale of assets			55	(1)		54
Operating income (loss)		(14,777)	113,256	7,309		105,788
Interest expense, net	(2)	18,678	199	(163)		18,712
Minority interest expense					1,917	1,917
Debt retirement costs		810				810
Other income		(185)				(185)
Equity interest in income of subsidiaries	50,254	73,221	5,555		(129,030)	
Income before provision (benefit) for income taxes	50,256	39,141	118,612	7,472	(130,947)	84,534
Provision (benefit) for income taxes	1	(11,113)	45,391			34,279
Net income	$50,255	$ 50,254	$ 73,221	$ 7,472	$(130,947)	$ 50,255

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VCA ANTECH, INC. AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED, CONSOLIDATING INCOME STATEMENTS
For the Nine Months Ended September 30, 2003
(Unaudited)
(In thousands)

	VCA	Vicar	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimination	Consolidated
Revenue	$	$	$381,388	$31,560	$ (724)	$412,224
Direct costs			271,368	24,770	(724)	295,414
Gross profit			110,020	6,790		116,810
Selling, general and administrative		12,649	14,767	1,130		28,546
Write-down and loss (gain) on sale of assets		(1)	283			282
Operating income (loss)		(12,648)	94,970	5,660		87,982
Interest expense, net	524	19,247	104	(104)		19,771
Minority interest expense					1,279	1,279
Debt retirement costs	7,417	1,701				9,118
Other expense		129				129
Equity interest in income of subsidiaries	38,707	58,617	4,485		(101,809)	
Income before provision (benefit) for income taxes	30,766	24,892	99,351	5,764	(103,088)	57,685
Provision (benefit) for income taxes	(3,256)	(13,815)	40,734			23,663
Net income	$34,022	$ 38,707	$ 58,617	$ 5,764	$(103,088)	$ 34,022

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VCA ANTECH, INC. AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED, CONSOLIDATING STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2004
(Unaudited)
(In thousands)

	VCA	Vicar	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimination	Consolidated
Cash flows from operating activities:						
Net income	$ 50,255	$ 50,254	$ 73,221	$ 7,472	$ (130,947)	$ 50,255
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Equity interest in earnings of subsidiaries	(50,254)	(73,221)	(5,555)		129,030	
Depreciation and amortization		1,180	9,659	568		11,407
Amortization of deferred financing costs and debt discount		548	4			552
Provision for uncollectible accounts			1,792	398		2,190
Debt retirement costs		810				810
Loss (gain) on sale of assets			55	(1)		54
Other			(350)			(350)
Minority interest in income of subsidiaries					1,917	1,917
Distributions to minority interest partners		(1,505)				(1,505)
Increase in trade accounts receivable		(3)	(4,546)	(526)		(5,075)
Decrease (increase) in inventory, prepaid expenses and other assets		(870)	58	(97)		(909)
Increase (decrease) in accounts payable and other accrued liabilities		6,255	(4,503)	7		1,759
Increase (decrease) in accrued payroll and related liabilities		4,447	(5,167)	43		(677)
Increase (decrease) in accrued interest		4,104	8	(5)		4,107
Decrease in prepaid income taxes		2,369				2,369
Increase in deferred income tax assets		(823)				(823)
Increase in deferred income tax liabilities		5,654				5,654

Increase (decrease) in intercompany payable/(receivable)	(2,370)	71,089	(60,828)	(7,891)		
Net cash provided by (used in) operating activities	(2,369)	70,288	3,848	(32)		71,735

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VCA ANTECH, INC. AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED, CONSOLIDATING STATEMENTS OF CASH FLOWS (Continued)
For the Nine Months Ended September 30, 2004
(Unaudited)
(In thousands)

	VCA	Vicar	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from investing activities:						
Business acquisitions, net of cash acquired	$	$ (97,152)	$	$	$	$ (97,152)
Real estate acquired in connection with business acquisitions		(5,565)				(5,565)
Property and equipment additions		(12,124)	(3,911)			(16,035)
Proceeds from sale of assets		182	2			184
Other	7	1,363	183			1,553
Net cash provided by (used in) investing activities	7	(113,296)	(3,726)			(117,015)
Cash flows from financing activities:						
Repayment of long-term obligations		(147,691)				(147,691)
Proceeds from issuance of long-term debt		225,000				225,000
Payment of financing costs		(794)				(794)
Proceeds from issuance of common stock under stock option plans	2,362					2,362
Net cash provided by financing activities.	2,362	76,515				78,877
Increase (decrease) in cash and cash equivalents		33,507	122	(32)		33,597
		14,883	2,244	110		17,237

Cash and cash equivalents at beginning of period						
Cash and cash equivalents at end of period	$	$ 48,390	$ 2,366	$ 78	$	$ 50,834

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VCA ANTECH, INC. AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED, CONSOLIDATING STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2003
(Unaudited)
(In thousands)

	VCA	Vicar	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimination	Consolidated
Cash flows from operating activities:						
Net income	$ 34,022	$ 38,707	$ 58,617	$ 5,764	$ (103,088)	$ 34,022
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Equity interest in earnings of subsidiaries	(38,707)	(58,617)	(4,485)		101,809	
Depreciation and amortization		1,109	9,070	474		10,653
Amortization of deferred financing costs and debt discount	14	655				669
Provision for uncollectible accounts			2,134	237		2,371
Debt retirement costs	7,417	1,701				9,118
Write-down of assets			392			392
Gain on sale of assets		(1)	(109)			(110)
Minority interest in income of subsidiaries					1,279	1,279
Distributions to minority interest partners.		(1,245)				(1,245)
Increase in trade accounts receivable		(5)	(4,251)	(143)		(4,399)
Decrease (increase) in inventory, prepaid expenses and other assets	108	100	(647)	1		(438)
Increase (decrease) in accounts payable and other accrued liabilities		1,233	(1,847)	62		(552)
Increase (decrease) in accrued payroll and related liabilities		2,478	(1,347)	(10)		1,121
Increase in accrued interest		4,166	24	2		4,192
Decrease in prepaid income taxes		7,614				7,614
Increase in income taxes payable		1,232				1,232
Increase in deferred income tax assets		(2,169)				(2,169)
Increase in deferred income tax liabilities		3,940				3,940

Increase (decrease) in intercompany payable/(receivable)	(15,067)	76,234	(54,756)	(6,411)		
Net cash provided by (used in) operating activities	(12,213)	77,132	2,795	(24)		67,690

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VCA ANTECH, INC. AND SUBSIDIARIES
NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CONDENSED, CONSOLIDATING STATEMENTS OF CASH FLOWS (Continued)
For the Nine Months Ended September 30, 2003
(Unaudited)
(In thousands)

	VCA	Vicar	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from investing activities:						
Business acquisitions, net of cash acquired	$	$ (27,177)	$	$	$	$ (27,177)
Real estate acquired in connection with business acquisitions		(589)				(589)
Property and equipment additions		(8,655)	(2,385)			(11,040)
Proceeds from sale of assets		355	8			363
Other	(5)	181	271			447
Net cash used in investing activities	(5)	(35,885)	(2,106)			(37,996)
Cash flows from financing activities:						
Repayment of long-term obligations, including redemption fees	(41,808)	(168,184)				(209,992)
Proceeds from the issuance of long-term debt		146,442				146,442
Repayment of revolving credit facility		(7,500)				(7,500)
Payment of financing costs	(382)	(687)				(1,069)
Proceeds from issuance of common stock under stock option plans	85					85
Proceeds from issuance of common stock	54,323					54,323
Net cash provided by (used in) financing activities	12,218	(29,929)				(17,711)

Increase (decrease) in cash and cash equivalents		11,318	689	(24)		11,983
Cash and cash equivalents at beginning of period		5,083	1,233	146		6,462
Cash and cash equivalents at end of period	$	$ 16,401	$ 1,922	$ 122	$	$ 18,445

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13. Subsequent Events

Acquisitions

From October 1, 2004 through November 3, 2004, the Company acquired one animal hospital, which was merged into an existing VCA animal hospital, for an aggregate consideration of $300,000, consisting of $275,000 in cash and the assumption of liabilities of $25,000.

On October 1, 2004, the Company acquired Sound Technologies, Inc. (STI) for $26.5 million, of which $23.0 million was paid with cash on-hand and the remaining $3.5 million will be paid in cash subject to STI achieving certain performance targets. STI is the nation s largest supplier of ultrasound and digital radiology equipment to the veterinary market.

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

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. Certain statements contained herein may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve a number or risks, uncertainties and other factors that could cause actual results to differ materially, as discussed more fully herein.

The forward-looking information set forth in this quarterly report on Form 10-Q is as of November 3, 2004, and we undertake no duty to update this information. Shareholders and prospective investors can find information filed with the SEC after November 3, 2004 at our website at www.investor.vcaantech.com or at the SEC s website at www.sec.gov. More information about potential factors that could affect our business and financial results is included in the section entitled Risk Factors.

Overview

We are a leading animal health care services company and operate the largest networks of veterinary diagnostic laboratories and freestanding, full-service animal hospitals in the United States. Our network of veterinary diagnostic laboratories provides sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. Our animal hospitals offer a full range of general medical and surgical services for companion animals. We treat diseases and injuries, offer pharmaceutical products and perform a variety of pet wellness programs, including health examinations, diagnostic testing, routine vaccinations, spaying, neutering and dental care.

At September 30, 2004, our laboratory network consisted of 26 laboratories serving all 50 states and our animal hospital network consisted of 318 animal hospitals in 36 states. We primarily focus on generating internal growth and acquiring individual animal hospitals to increase revenue and profitability. However, we may pursue acquisitions of animal hospital chains, laboratories or related businesses if favorable opportunities are presented. In accord with that strategy, we acquired the following companies:

On June 1, 2004, we acquired National PetCare Centers, Inc., or NPC, (discussed below), which at the date of acquisition, operated 67 animal hospitals; and

On October 1, 2004, we acquired Sound Technologies, Inc., or STI, (discussed below), which is the nation s largest supplier of ultrasound and digital radiology equipment to the veterinary market.

Significant Acquisitions

National PetCare Centers, Inc.

On June 1, 2004, the Company consummated a merger with NPC, which operated 67 animal hospitals located in 11 states as of the merger date. This merger allowed us to expand our animal hospital operations in nine states, particularly California and Texas, and to expand into two new states, Oregon and Oklahoma.

As of September 30, 2004, we had not finalized the purchase price accounting for the transaction. The total consideration as of September 30, 2004 was $91.5 million, consisting of $66.2 million in cash paid to holders of NPC stock and debt; $2.5 million in assumed debt; $12.8 million in assumed liabilities; $5.9 million of operating leases whose terms were in excess of market; $2.0 million paid for professional and other outside services; and $2.1 million paid as part of the Company s plan to close certain facilities and terminate certain employees.

As part of our integration plan, we have closed NPC s corporate office and intend to close or sell animal hospitals that do not meet our operating model and eliminate NPC s employees with duplicative functions. We have commenced these activities but, as of September 30, 2004, had not yet determined the total related costs. Costs incurred in connection with the integration plan, consisting primarily of lease termination costs and employee severance costs, will result in additions to the total purchase price of the transaction.

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During the three and nine months ended September 30, 2004, we incurred other integration costs of $668,000 and $1.2 million. The integration process is substantially complete and we do not expect to incur any additional material integration costs during the remainder of 2004. These integration costs are expensed as incurred and included in corporate selling, general and administrative expense.

The gross profit margins for NPC s animal hospitals have been historically lower than the gross profit margins for animal hospitals which we have acquired and fully integrated into our operations. As a result, we expect the integration of NPC to lower our animal hospital margins. We believe that the gross profit margins for NPC s animal hospitals will improve as we fully integrate their operations and we fully realize operating efficiencies.

Sound Technologies, Inc.

On October 1, 2004, we acquired STI, which is the nation s largest supplier of ultrasound and digital radiology equipment to the veterinary market. The current trend in the veterinary market is toward more advanced diagnostic tools, and STI offers state-of-the-art integrated diagnostic imaging solutions. STI is also a value-added reseller of ultrasound machines for General Electric. We believe that improving the diagnostic capabilities of our animal hospitals and expanding our laboratory operations into advanced imaging diagnostics is a natural extension of our operations and long-term goals.

We have not finalized the purchase price accounting for this transaction, however, we acquired STI for $26.5 million, of which $23.0 million was paid with cash on-hand and the remaining $3.5 million will be paid in cash subject to STI achieving certain performance targets.

Growth in Facilities

The following table summarizes our growth in facilities:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2004	**2003**	**2004**	**2003**
Laboratories:				
Beginning of period	25	23	23	19
Acquisitions		1		7
New facilities	1		3	
Acquisitions relocated into other labs operated by us		(1)		(3)
End of period	26	23	26	23
Animal hospitals:				
Beginning of period	317	238	241	229
Acquisitions	2	3	84	19

New facilities	1		1	
Acquisitions relocated into hospitals operated by us	(1)		(4)	(5)
Sold or closed	(1)		(4)	(2)
End of period	318	241	318	241

Stock Dividend

On August 25, 2004, we effected a two-for-one stock split in the form of a 100% stock dividend payable to stockholders of record as of August 11, 2004. All share and per share information included in this document have been restated to reflect the effect of the stock dividend.

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Reclassifications

During 2004, we began including depreciation and amortization in direct costs and selling, general and administrative expense. Prior periods presented have been reclassified to reflect this change.

Adoption of FIN No. 46R

We adopted Financial Accounting Standards Board, FASB, Interpretation No. 46R, or FIN No. 46R, *Consolidation of Variable Interest Entities*, in the fourth quarter of 2003 and accordingly, restated the prior periods to conform to the current period presentation. Pursuant to FIN No. 46R, we consolidate the operating results of the veterinary medical groups for which we provide management services. The result of the consolidation is an increase in both revenue and direct costs by an equal amount, thus there is no impact on operating income, net income, earnings per share or cash flows. However, hospital and consolidated operating margins are lower than our historical reported margins because of the increase in revenue without a corresponding increase in operating income or net income.

Basis of Reporting

General

Our discussion and analysis of our financial condition and results of operations are based upon our unaudited condensed, consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States of America, or GAAP. We report our operations in three segments: laboratory, animal hospital and corporate.

The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expense, and related disclosure of contingent assets and liabilities. We evaluate our estimates on an on-going basis. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Our estimates form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates due to changes in future conditions.

Revenue Recognition

We recognize revenue only after the following criteria are met:

- there exists adequate evidence of the transaction;
- delivery of goods has occurred or services have been rendered; and
- the price is not contingent on future activity and collectibility is reasonably assured.

We report our revenue net of sales discounts.

Laboratory Revenue

Laboratory internal revenue growth was calculated using laboratory revenue as reported, adjusted to exclude revenue for the newly acquired laboratories that we did not own for the entire period presented and adjusted for the impact resulting from any differences in the number of billing days in comparable periods.

Approximately 7% of laboratory revenue for the nine months ended September 30, 2004 is intercompany revenue that was generated by providing laboratory services to our animal hospitals. For purposes of reviewing the operating performance of the business segments, all intercompany revenue is accounted for as if the transaction was with an independent third-party at current market prices. For financial reporting purposes, intercompany revenue is eliminated as part of our consolidation.

We give discounts, such as those for prompt payment, to clients in periods subsequent to the period the related revenue was recognized, however, we report the related revenue net of those discounts. In order to net the discounts against the related revenue, we estimate the discounts based on historical experience. We do not expect that revisions to these discounts would have a material effect on our condensed, consolidated financial statements.

Animal Hospital Revenue

Certain states prohibit business corporations from providing, or holding themselves out as providers of, veterinary medical care. In these states, we provide administrative and support services to veterinary medical groups pursuant to management agreements. The veterinary medical groups are each solely responsible for all aspects of the practice of veterinary medicine. In return for our services, the veterinary medical groups pay us management fees. We consolidate the financial results of these veterinary medical groups.

Same-store revenue growth includes revenue generated by customers referred from our relocated or combined animal hospitals, including those combined upon acquisition and adjusted for the impact resulting from any differences in the number of business days in comparable periods.

Direct Costs

Laboratory direct costs are comprised of all costs of laboratory services, including salaries of veterinarians, specialists, technicians and other non-administrative, laboratory-based personnel, facilities rent, occupancy costs, depreciation and amortization, and supply costs.

Animal hospital direct costs are comprised of all costs of services and products at the animal hospitals, including 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.

Selling, General and Administrative Expense

Our selling, general and administrative expense is divided between our laboratory, animal hospital and corporate segments. Laboratory selling, general and administrative expense consists primarily of salary-related sales, administrative, accounting personnel, selling, marketing and promotional expense. Animal hospital selling, general and administrative expense consists primarily of field management, certain administrative and accounting personnel, recruiting and certain marketing expense. Corporate selling, general and administrative expense consists of administrative expense at our headquarters, including the salaries of corporate officers, rent, accounting, finance, legal and other professional expense and occupancy costs as well as corporate depreciation.

Software Development Costs

We frequently develop and implement new software to be used internally, or enhance our existing internal software. We develop the software using our own employees and/or outside consultants. Costs associated with the development of new software are expensed as incurred. Costs related directly to the software design, coding, testing and installation are capitalized and amortized over the expected life of the software, generally three years. Costs related to upgrades or enhancements of existing systems are capitalized if the modifications result in additional functionality.

Critical Accounting Policies and Significant Estimates

We are required to make significant accounting estimates that directly impact our consolidated financial statements and related disclosures. Significant estimates are estimates that meet two criteria: (1) the estimates require that we make assumptions about matters that are highly uncertain at the time the estimates are made; and (2) there exist different estimates that could reasonably be used in the current period, or changes in the estimates used are reasonably likely to occur from period to period, both of which would have a material impact on the presentation of the financial condition or results of operations. We base our assumptions and estimates on historical experience and on various other factors believed to be reasonable under the circumstances. We have discussed with our audit committee the critical accounting policies for our company, the basis for their underlying assumptions and estimates and the nature of our related disclosures herein. We believe the critical accounting policies for our company that are most affected by significant estimates and judgments are as follows:

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Workers Compensation Expense

Workers compensation expense is the cost to insure our company against losses related to injuries incurred by our employees in the normal course of their duties. In 2001, we restructured our workers compensation insurance policies to a self-insurance retention program. The effect of this restructuring was a shift of the significant portion of the financial risk associated with claims losses from the insurance company to our company, while the insurance company bears only the financial risk of large individual losses and large aggregate losses.

We estimate the amount that we will ultimately pay for losses associated with workers compensation claims, or claims losses for the policy period. These estimated claims losses are recorded as expense during the policy period. Claims losses can vary substantially and, because they can take years to develop fully, can be difficult to estimate. These estimates are based on complex judgments regarding the probable number of claims that will be filed and the nature of those claims. Both of those variables are highly uncertain and combine to form a factor referred to as the loss pick. The loss pick factor is multiplied by our payroll cost to determine what the projected costs for claims and our related expense will be.

We estimate the loss pick by reviewing a minimum of five years of our historical claims loss data and analyzing the trend of the development of claims over time. We also review and adjust the loss pick for other major factors such as the risk control environment and claims handling. We review our loss pick on a quarterly basis considering the current loss trend and any changes in the environment as indicated above. The loss pick is then applied to our actual payroll costs to estimate the claims loss portion of our workers compensation expense for the given period.

Our insurance carriers require us to pre-fund claims at a certain loss pick (the low-end in the following table), and give us a maximum loss pick (the high-end in the following table), above which the carrier is responsible for paying all claims. The ranges set forth by the insurance carrier reflect the most probable potential for our workers compensation claims losses. The increase in the insurance carriers range reflects the trend over the last several years toward increasing workers compensation costs. Based on these ranges, and the factors described above, we estimated our losses using a loss pick of 2.10% for the policy years ended September 30, 2004 and 2003. The increase in our loss pick reflects an increase in our claims loss trend during the previous years.

The following table reflects the loss pick percentages and total estimated claims expense recorded by us and the probable ranges for the ultimate realized loss picks and claims expense (in thousands):

		Claims Expense Recorded		Estimated Claims Expense Range			
				Low-End		High-End	
	Payroll	%	$	%	$	%	$
Policy year ended 9/30/04	$218,476	2.10%	$ 4,588	1.53%	$3,343	2.82%	$ 6,154
Policy year ended 9/30/03	185,907	2.10%	3,904	1.59%	2,931	2.55%	4,741
Policy year ended 9/30/02	169,022	2.04%	3,441	1.54%	2,603	2.49%	4,208
Total	$573,405	2.08%	$11,933	1.55%	$8,877	2.63%	$15,103

We recognize the claims expense as part of the overall workers compensation expense in direct costs and selling, general and administrative expense of our segments, based on their respective payroll cost and the loss pick percentage discussed and shown above, to calculate the claims loss portion of the expense. The difference between the minimum amount of claims losses pre-funded to the insurance carrier and the amount expensed is accrued and included in other accrued liabilities. If our estimates prove to be incorrect as the losses develop over several years, we may have to adjust the accrual accordingly, and also may have to either pay additional claims losses or receive refunds from our insurance carriers. This could result in a need for us to recognize additional expense or have expense reduced in future periods within the range shown above.

The insurance policies in place prior to September 30, 2001 did not have large deductibles, and we have accrued for exposure under these policies.

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In connection with the NPC merger, we assumed additional workers compensation claim liabilities in the amount of $1.1 million, related to self-insurance retention policies for four policy years. We reviewed policy terms, claims history and current claims status for each policy to determine that the assumed liability is adequate.

Valuation of Goodwill

Our goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to identifiable assets acquired and liabilities assumed. The total amount of our goodwill at September 30, 2004 was $481.1 million, consisting of $93.7 million for our laboratory operating segment and $387.4 million for our animal hospital operating segment.

Annually, and upon material changes in our operating environment, we test our goodwill for impairment by comparing the fair market value of our reporting units, which equate to our laboratory and animal hospital operating segments, to their respective net book value. At December 31, 2003, we estimated the fair market value of each of our operating segments and determined that the estimated fair value of each exceeded their respective net book value, resulting in a conclusion that our goodwill was fairly stated.

We will review our goodwill for impairment again at December 31, 2004 or upon material changes in our operating environment.

Allowance for Uncollectible Accounts

The allowance for uncollectible accounts is estimated based primarily upon age of accounts receivable and loss history. Accounts receivable balances are routinely reviewed in conjunction with collection efforts, historical collection rates and other economic conditions that might ultimately affect the collectibility of accounts when considering the adequacy of the amounts recorded as allowance for uncollectible accounts. Significant changes in client mix or economic conditions could affect our collection of accounts receivable, cash flows and results of operations.

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Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
		(Restated)		(Restated)
Revenue:				
Laboratory	27.6%	32.3%	30.5%	32.7%
Animal hospital	74.4	69.5	71.5	69.2
Intercompany	(2.0)	(1.8)	(2.0)	(1.9)
Total revenue	100.0	100.0	100.0	100.0
Direct costs	72.8	71.5	72.0	71.7
Gross profit	27.2	28.5	28.0	28.3
Selling, general and administrative	7.1	6.5	6.7	6.9
Loss (gain) on sale of assets	0.1	0.3		0.1
Operating income	20.0	21.7	21.3	21.3
Interest expense, net	3.6	4.4	3.8	4.8
Debt retirement costs		1.2	0.2	2.2
Other (income) expense		(0.1)	(0.1)	
Minority interest expense	0.4	0.3	0.4	0.3
Income before provision for income taxes	16.0	15.9	17.0	14.0
Provision for income taxes	6.5	6.5	6.9	5.7
Net income	9.5%	9.4%	10.1%	8.3%

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The following is a summary of the components of operating income (loss) and operating margin by segment (in thousands):

	Laboratory	Animal Hospital	Corporate	Inter-company Eliminations	Total
Three Months Ended September 30, 2004					
Revenue	$ 50,685	$ 136,399	$	$ (3,732)	$ 183,352
Direct costs	28,470	108,833		(3,732)	133,571
Gross profit	22,215	27,566			49,781
Selling, general and administrative	3,136	3,423	6,478		13,037
Gain on sale of assets		(12)			(12)
Operating income (loss)	$ 19,079	$ 24,155	$ (6,478)	$	$ 36,756
Operating margin	37.6%	17.7%	(3.5)%		20.0%
Depreciation and amortization	$ 850	$ 2,722	$ 400	$	$ 3,972
Three Months Ended September 30, 2003					
Revenue	$ 46,429	$ 100,060	$	$ (2,605)	$ 143,884
Direct costs	26,664	78,789		(2,605)	102,848
Gross profit	19,765	21,271			41,036
Selling, general and administrative	2,855	2,516	3,982		9,353
Write-down and loss on sale of assets	39	403			442
Operating income (loss)	$ 16,871	$ 18,352	$ (3,982)	$	$ 31,241
Operating margin	36.3%	18.3%	(2.8)%		21.7%

Depreciation and amortization	$ 823	$ 2,387	$ 369	$	$ 3,579
Nine Months Ended September 30, 2004					
Revenue	$151,818	$355,739	$	$(9,908)	$497,649
Direct costs	84,168	284,044		(9,908)	358,304
Gross profit	67,650	71,695			139,345
Selling, general and administrative	9,499	9,227	14,777		33,503
Loss on sale of assets	1	53			54
Operating income (loss)	$ 58,150	$ 62,415	$(14,777)	$	$105,788
Operating margin	38.3%	17.5%	(3.0)%		21.3%
Depreciation and amortization	$ 2,568	$ 7,659	$ 1,180	$	$ 11,407
Nine Months Ended September 30, 2003					
Revenue	$134,818	$285,189	$	$(7,783)	$412,224
Direct costs	76,489	226,708		(7,783)	295,414
Gross profit	58,329	58,481			116,810
Selling, general and administrative	8,359	7,538	12,649		28,546
Write-down and loss (gain) on sale of assets	58	225	(1)		282
Operating income (loss)	$ 49,912	$ 50,718	$(12,648)	$	$ 87,982
Operating margin	37.0%	17.8%	(3.1)%		21.3%
Depreciation and amortization	$ 2,376	$ 7,168	$ 1,109	$	$ 10,653

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Revenue

The following table summarizes our revenue (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	**2003**	**% Change**	**2004**	**2003**	**% Change**
Laboratory	$ 50,685	$ 46,429	9.2%	$151,818	$134,818	12.6%
Animal hospital	136,399	100,060	36.3%	355,739	285,189	24.7%
Intercompany	(3,732)	(2,605)		(9,908)	(7,783)	
Total revenue	$183,352	$143,884	27.4%	$497,649	$412,224	20.7%

Laboratory Revenue

Laboratory revenue increased $4.3 million for the three months ended September 30, 2004 and increased $17.0 million for the nine months ended September 30, 2004 compared to the same periods in the prior year. The components of the increase in laboratory revenue are detailed below (in thousands, except average price per requisition):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	**2003**	**% Change**	**2004**	**2003**	**% Change**
Laboratory Revenue:						
Internal growth:						
Number of requisitions	2,137	2,069	3.3%	6,429	6,137	4.8%
Average revenue per requisition (1)	$ 23.72	$ 22.44	5.7%	$ 22.96	$ 21.97	4.5%
Total internal revenue (2)	$50,685	$46,429	9.2%	$147,626	$134,818	9.5%
Billing day adjustment (3)				606		
Acquired revenue				3,586		
Total	$50,685	$46,429	9.2%	$151,818	$134,818	12.6%

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

(2) Numbers may not calculate exactly due to rounding.

(3) The 2004 billing day adjustment reflects the impact of one additional billing day for the nine months ended September 30, 2004 as compared to the same period in the prior year.

Laboratory internal revenue growth was 9.2% and 9.5% for the three and nine months ended September 30, 2004, despite the impact of the hurricanes in the Southeastern United States. Excluding the Florida market, which was the market most significantly impacted by the hurricanes, laboratory internal revenue growth was 10.1% and 9.8% for the three and nine months ended September 30, 2004.

The increases in the number of requisitions from internal growth for the three and nine months ended September 30, 2004 are the result of a continued trend in veterinary medicine to focus on the importance of laboratory diagnostic testing in the diagnosis and treatment of diseases. This trend is driven by an increase in the number of specialists in the veterinary industry relying on diagnostic testing, the increased focus on diagnostic testing in veterinary schools and general increased awareness through ongoing marketing and continuing education programs provided by ourselves, pharmaceutical companies and other service providers in the industry. In addition, we continue to see the impact from the recent migration of diagnostic testing from the human health care industry and the advent of medicine in the veterinary industry that requires diagnostic assessment and monitoring.

The increases in the average revenue per requisition for the three and nine months ended September 30, 2004 is primarily attributable to price increases and changes in the mix of tests performed per requisition. Price increases approximated 2% to 4% in February 2004 and 3% to 5% in February 2003.

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As the result of our laboratory acquisitions subsequent to January 1, 2003, we generated an additional $3.6 million of revenue (referred to in the above table as acquired revenue) during the nine months ended September 30, 2004 in comparison to the same period in the prior year.

Animal Hospital Revenue

Animal hospital revenue increased $36.3 million for the three months ended September 30, 2004 and increased $70.6 million for the nine months ended September 30, 2004 compared to the same periods in the prior year. The components of the increases are summarized in the following table (in thousands, except average price per order):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	**2003**	**% Change**	**2004**	**2003**	**% Change**
Animal Hospital Revenue:						
Same-store:						
Orders	921	939	(2.0)%	2,576	2,600	(0.9)%
Average revenue per order (1)	$ 110.80	$ 105.67	4.9%	$ 110.83	$ 105.26	5.3%
Same-store revenue (2)	$102,024	$ 99,230	2.8%	$285,533	$273,664	4.3%
Business day adjustment (3)	1,307			2,421		
Net acquired revenue	33,068	830		67,785	11,525	
Total	$136,399	$100,060	36.3%	$355,739	$285,189	24.7%

(1) Computed by dividing same-store revenue by same-store orders.

(2) Numbers may not calculate exactly due to rounding.

(3) The 2004 business day adjustment reflects the impact of one additional business day for the three months ended September 30, 2004 as compared to the same period in the prior year and two additional business days for the nine months ended September 30, 2004 as compared to the same period in the prior year.

Over the last few years, certain pet-related products traditionally sold at animal hospitals have become more widely available in retail stores and other distribution channels, and, as a result, we have fewer customers coming to our animal hospitals solely to purchase such items. In addition, there has been a decline in the number of vaccinations as some recent professional literature and research has suggested that vaccinations can be given to pets less frequently. Orders for these pet-related products and vaccinations generally generate revenue that is less than the average revenue for all orders. In addition, our business strategy has placed greater emphasis on high-quality veterinary care and wellness programs, which are higher priced orders. These trends have resulted in a decrease in the number of orders and an increase in the average revenue per order.

Price increases also contributed to the increase in the average revenue per order, which approximated 2.5% to 5% on services at most hospitals in both February 2004 and 2003. Prices are reviewed on an annual basis for each hospital and adjustments are made based on market considerations, demographics and our costs.

Net acquired revenue represents the revenue from those hospitals acquired, sold or closed on or after the beginning of the comparative period, which was July 1, 2003 for the three months ended September 30, 2004 and January 1, 2003 for the nine months ended September 30, 2004. Fluctuations in net acquired revenue occur due to the volume, size, and timing of acquisitions and disposals during the periods compared.

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Gross Profit

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

	Three Months Ended September 30,					Nine Months Ended September 30,				
	2004		2003			2004		2003		
	$	Gross Profit Margin	$	Gross Profit Margin	% Change	$	Gross Profit Margin	$	Gross Profit Margin	% Change
Laboratory	$22,215	43.8%	$19,765	42.6%	12.4%	$ 67,650	44.6%	$ 58,329	43.3%	16.0%
Animal hospital	27,566	20.2%	21,271	21.3%	29.6%	71,695	20.2%	58,481	20.5%	22.6%
Total gross profit	$49,781	27.2%	$41,036	28.5%	21.3%	$139,345	28.0%	$116,810	28.3%	19.3%

Laboratory Gross Profit

The increase in laboratory gross profit margins during the three and nine months ended September 30, 2004 was primarily attributable to increases in laboratory revenue combined with operating leverage associated with our laboratory business. Our operating leverage comes from the incremental margins we realize on additional tests ordered by the same client, as well as when more comprehensive tests are ordered. We are able to benefit from these incremental margins due to the relative fixed cost nature of our laboratory business.

Animal Hospital Gross Profit

Since January 1, 2004, we have had significant growth in our animal hospital division as a result of the acquisition of 84 hospitals, 67 of which were acquired in the NPC merger on June 1, 2004. Our animal hospital gross profit margin decreased for the three and nine months ended September 30, 2004, compared to the same periods in the prior year, primarily as a result of the impact of the relatively large number of hospitals we recently acquired. As expected, the hospitals we recently acquired, as a group, had a gross profit margin lower than those animal hospitals that we have operated for a period of time sufficient to allow us to fully achieve operating efficiencies.

In addition, during 2004, we completed the construction of two new specialty/referral animal hospitals in Chicago and Manhattan. During the third quarter of 2004, gross profit margins on the specialty/referral animal hospitals were significantly lower than the gross profit margins on our other animal hospitals due to a decrease in revenues resulting from business interruptions during the construction and integration period coupled with an increase in costs, including but not limited to, rent, salary and depreciation. We expect that the margins on these specialty/referral practices will normalize to levels consistent with our other specialty/referral animal hospitals once the integration process is completed.

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Selling, General and Administrative Expense

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

	Three Months Ended September 30,					Nine Months Ended September 30,				
	2004		2003			2004		2003		
	$	% of Revenue	$	% of Revenue	% Change	$	% of Revenue	$	% of Revenue	% Change
Laboratory	$ 3,136	6.2%	$2,855	6.1%	9.8%	$ 9,499	6.3%	$ 8,359	6.2%	13.6%
Animal hospital	3,423	2.5%	2,516	2.5%	36.0%	9,227	2.6%	7,538	2.6%	22.4%
Corporate	6,478	3.5%	3,982	2.8%	62.7%	14,777	3.0%	12,649	3.1%	16.8%
Total SG&A	$13,037	7.1%	$9,353	6.5%	39.4%	$33,503	6.7%	$28,546	6.9%	17.4%

Laboratory SG&A

The increase in laboratory SG&A as a percentage of laboratory revenue during the three and nine months ended September 30, 2004 as compared to the same periods in the prior year was primarily due to the result of hiring additional sales personnel.

Animal Hospital SG&A

Animal hospital SG&A as a percentage of animal hospital revenue during the three and nine months ended September 30, 2004 was consistent with the same period in the prior year.

Corporate SG&A

In March 2004, a claim with our insurance company was settled that provided for the partial reimbursement of the Zoasis Corporation litigation settlement incurred in 2002 and related legal fees. In addition, during the three and nine months ended September 30, 2004, we incurred integration costs in connection with the NPC merger. The following table reconciles corporate SG&A as reported to corporate SG&A excluding the insurance claim settlement and integration costs (in thousands):

	Three Months Ended September 30,					Nine Months Ended September 30,				
	2004		2003			2004		2003		
		% of		% of	%		% of		% of	%

	$	Revenue	$	Revenue	Change	$	Revenue	$	Revenue	Change
Corporate SG&A as reported	$6,478	3.5%	$3,982	2.8%	62.7%	$14,777	3.0%	$12,649	3.1%	16.8%
Impact of certain items:										
Litigation settlement reimbursement						1,124				
Legal fees reimbursement						801				
Integration costs	(668)					(1,238)				
Corporate SG&A excluding the insurance claim settlement and integration costs	$5,810	3.2%	$3,982	2.8%	45.9%	$15,464	3.1%	$12,649	3.1%	22.3%

Excluding the impact of the insurance claim settlement and integration costs, Corporate SG&A increased during the three months ended September 30, 2004 and the nine months ended September 30, 2004 primarily as a result of costs incurred for internal controls compliance activities pertaining to Section 404 of the Sarbanes-Oxley Act.

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Interest Expense, Net

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Interest expense:				
Revolving credit facility	$	$	$	$ 27
Senior term C notes		973		4,648
Senior term D notes		707	2,235	707
Senior term E notes	2,166		2,800	
9.875% senior subordinated notes	4,197	4,197	12,591	12,591
15.5% senior notes				522
Interest-rate hedging agreements	90	165	419	352
Amortization of deferred financing costs and debt discount	185	213	552	669
Secured seller notes & other	214	177	595	545
	6,852	6,432	19,192	20,061
Interest income	223	71	480	290
Total interest expense, net of interest income	$6,629	$6,361	$18,712	$19,771

The changes in interest expense were primarily attributable to our debt financing transactions, which we discuss below in Liquidity and Capital Resources, and changes in LIBOR.

Debt Retirement Costs

On June 1, 2004, we amended and restated our senior credit facility to replace the existing senior term D notes in the principal amount of $145.3 million with an interest rate margin of 2.50% with new senior term E notes in the principal amount of $225.0 million with an interest rate margin of 2.25%. The additional borrowings were used to fund the NPC merger, which we discuss above in Significant Acquisitions. In conjunction with amending and restating our senior credit facility, we recorded debt retirement costs of $810,000.

In August 2003, we refinanced our senior credit facility to replace the existing senior term C notes in the principal amount of $166.4 million with an interest rate margin of 3.00% with $20.0 million of cash on-hand and new senior term D notes in the principal amount of $146.4 million with an interest rate margin of 2.50%. In conjunction with that transaction, we recorded debt retirement costs of $1.7 million.

On February 4, 2003, we voluntarily retired the entire principal amount of our 15.5% senior notes with net proceeds received from the sale of our common stock. In conjunction with that transaction, we recorded debt retirement costs of $7.4 million.

Provision for Income Taxes

We recognized a litigation settlement reimbursement of $1.1 million during the first quarter of 2004, which we discuss above in Corporate SG&A. This reimbursement had no related tax expense and reduced our effective tax rate to 40.6% for the nine months ended September 30, 2004. This reimbursement will not impact our effective tax rate for individual quarters ending subsequent to March 31, 2004. Our effective tax rate for the three months ended September 30, 2004 was 41.0%.

Liquidity and Capital Resources

Cash and Cash Equivalents

Cash and cash equivalents at September 30, 2004 totaled $50.8 million, up from $17.2 million at December 31, 2003. The increase is a result of net cash provided by operations and financing exceeding net cash used in investing activities.

Cash Flows from Operating Activities

Net cash provided by operating activities increased $4.0 million for the nine months ended September 30, 2004 compared to the same period in the prior year. This increase is primarily due to: (a) improved operating performance; (b) acquisitions; and (c) a $667,000 decrease in interest paid. This increase was partially offset by: (a) a $14.0 million increase in taxes paid; and (b) a use of $815,000 from changes in working capital.

Cash Flows used in Investing Activities

In each of the nine-month periods ended September 30, 2004 and 2003, net cash used in investing activities was primarily comprised of cash used for the acquisition of animal hospitals and laboratories and expenditures for property and equipment. The significant increase in cash used for acquisitions was the result of spending approximately $70.3 million to acquire NPC.

We anticipate spending an additional $275,000 for animal hospital acquisitions and up to $5.5 million for property and equipment during the remainder of 2004. However, we may spend more for acquisitions than we are currently planning depending upon opportunities that present themselves and our cash requirements may change accordingly. In addition, there may be acquisition opportunities in the laboratory field that may change our cash requirements. We intend to primarily use cash in our acquisitions but, depending upon the timing and amount of our acquisitions, we may use stock or debt to the extent we deem it appropriate. Our covenants under our senior credit facility, as amended and restated on June 1, 2004, permitted the NPC merger and allow us to spend $50.0 million per year plus up to $5.0 million of any unused amount from the prior year on other acquisitions, and we would require a waiver or amendment to the covenant to exceed this amount.

We consummated a merger with STI on October 1, 2004, pursuant to which we acquired STI for $26.5 million, of which $23.0 million was paid with cash on-hand and the remaining $3.5 million will be paid in cash subject to STI achieving certain performance targets.

Cash Flows from Financing Activities

On June 1, 2004, we amended and restated our senior credit facility to replace the existing senior term D notes in the principal amount of $145.3 million with an interest rate margin of 2.50% with new senior term E notes in the principal amount of $225.0 million with an interest rate margin of 2.25%. The additional borrowings were used to fund the acquisition of NPC, which we discuss above in Significant Acquisitions.

In August 2003, we refinanced our senior credit facility to replace the existing senior term C notes in the principal amount of $166.4 million with an interest rate margin of 3.00% with $20.0 million of cash on-hand and new senior term D notes in the principal amount of $146.4 million with an interest rate margin of 2.50%.

In February 2003, we completed an offering of common stock at an issue price of $15.25 per share, in which we sold 3.8 million shares of our common stock in exchange for net proceeds of $54.3 million. Approximately $42.7 million of the net proceeds received were used to redeem the entire principal amount of our 15.5% senior notes due 2010 at a redemption price of 110% of the principal amount, plus accrued and unpaid interest.

Borrowings and repayments under our revolving credit facility are the result of normal working capital shifts created by the seasonality of our business and the timing of acquisition activity. In the fourth quarter of 2002 we borrowed $7.5 million, and in early 2003 we repaid the full amount. We have not borrowed on the revolving credit facility since the fourth quarter of 2002.

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Future Cash Requirements

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

	Total	2004 (1)	2005	2006	2007	2008	Thereafter
Long-term debt	$397,227	$ 1,001	$ 3,147	$29,539	$110,284	$ 82,634	$170,622
Capital lease obligations	427	48	190	100	64	25	
Operating leases	372,600	5,593	22,558	22,433	22,382	22,170	277,464
Fixed cash interest expense	94,086	8,563	17,417	17,254	16,914	17,044	16,894
Variable cash interest expense (2)	42,084	2,518	11,680	13,764	10,934	3,188	
Deferred income tax liabilities	30,485						30,485
Mandatorily redeemable partnership interests	2,099						2,099
Swap agreements (2)	(297)	(66)	(231)				
	$938,711	$17,657	$54,761	$83,090	$160,578	$125,061	$497,564

(1) Consists of the period October 1 through December 31, 2004.

(2) We have both fixed-rate and variable-rate debt. The interest payments on our variable-rate debt are based on a variable-rate component plus a fixed 2.25%. Including the fixed 2.25%, we estimate that the interest rate on our variable-rate debt will be 4.5%, 5.25%, 6.25%, 7.25%, and 7.75% for years 2004 through 2008, respectively. These estimates are based on interest rate projections used to price our interest rate swap agreements. Our consolidated financial statements included in our 2003 Annual Report on Form 10-K discuss these variable-rate notes in more detail.

The table above excludes certain contractual arrangements whereby additional cash may be paid to former owners of acquired companies, including STI, upon attainment of specified performance targets. We may be required to pay up to $4.6 million in future periods if these performance targets are achieved.

We anticipate that our cash on hand, cash from operations and, if needed, our revolving credit facility will provide sufficient cash resources to fund our contractual obligations and other cash needs for more than the next 12 months.

Debt Covenants

Our senior credit facility contains certain financial covenants pertaining to interest coverage, 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 September 30, 2004, we were in compliance with these covenants. We currently believe the most restrictive covenant is the fixed charge coverage ratio. The senior credit facility defines the fixed charge coverage ratio as that ratio which is calculated on a last twelve-month basis by dividing pro forma earnings before interest, taxes, depreciation and amortization, as defined by the agreement, by fixed charges. Fixed charges are defined as cash interest expense, scheduled principal payments on debt obligations, capital expenditures, and provision for income taxes. At September 30, 2004, we had a fixed charge coverage ratio of 1.55 to 1.00, which was in compliance with the required ratio of no less than 1.10 to 1.00.

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Interest-Rate Hedging Agreements

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

	Swap #1	**Swap #2**	**Swap #3**
Fixed interest rate	2.22%	1.72%	1.51%
Notional amount	$40.0 million	$20.0 million	$20.0 million
Effective date	11/29/2002	5/30/2003	5/30/2003
Expiration date	11/29/2004	5/31/2005	5/31/2005
Counter party	Wells Fargo Bank	Wells Fargo Bank	Goldman Sachs

We entered into the swap agreements to hedge against the risk of increasing interest rates. The contracts effectively convert a certain amount of our variable-rate debt under our senior credit facility to fixed-rate debt for purposes of controlling cash paid for interest. That amount is equal to the notional amount of the swap agreements and the fixed rate conversion period is equal to the terms of the contract. The impact of the swap agreements has been factored into our future contractual cash requirements table above.

In the future, we may enter into additional interest rate strategies to take advantage of favorable current rate environments. We have not yet determined what those strategies will be or their possible impact.

Description of Indebtedness

Senior Credit Facility

At September 30, 2004, we had $223.9 million principal amount outstanding under our senior term E notes and no borrowings outstanding under our revolving credit facility.

Borrowings under the senior credit facility bear interest, at our option, on either the base rate, which is the higher of the administrative agent s prime rate or the Federal Funds Rate plus 0.5% plus a base rate margin, or the adjusted eurodollar rate, which is the rate per annum obtained by dividing (1) the rate of interest offered to the administrative agent 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 plus a eurodollar rate margin. The base rate margins for the revolving credit facility range from 1.00% to 2.25% per annum and the margin for the senior term E notes is 1.25% per annum. The eurodollar rate margins for the revolving credit facility range from 2.00% to 3.25% per annum and the margin for the senior term E notes is 2.25% per annum.

The senior term E notes mature in September 2008 and the revolving credit facility matures in September 2006.

9.875% Senior Subordinated Notes

On November 27, 2001, Vicar Operating, Inc., our wholly-owned subsidiary, issued $170.0 million in principal amount of senior subordinated notes due December 1, 2009, which were exchanged on June 13, 2002 for substantially similar securities that are registered under the Securities Act. Interest on these senior subordinated notes is 9.875% per annum, payable semi-annually in arrears in cash. At September 30, 2004, the outstanding principal balance of these senior subordinated notes was $170.0 million. We and each existing domestic wholly-owned subsidiary of Vicar have jointly and severally, fully and unconditionally guaranteed these notes. Future domestic wholly-owned subsidiaries of Vicar will also be required to guarantee these notes. These guarantees are unsecured and subordinated in right of payment to all existing and future indebtedness outstanding under the credit and guaranty agreement and any other indebtedness permitted to be incurred by Vicar under the terms of the indenture agreement governing these notes.

Before December 1, 2004, we can redeem up to $59.5 million of principal on our 9.875% senior subordinated notes at a redemption price of 109.9% of the principal amount with proceeds from an equity offering. The remaining portion may be paid off at our discretion beginning December 1, 2005 at a redemption price of 104.9% of the principal amount.

Other Debt

At September 30, 2004, we had seller notes secured by assets of animal hospitals, unsecured debt and capital leases that totaled $3.8 million.

Risk Factors

This Form 10-Q, including *Risk Factors* set forth below, contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they materialize or prove incorrect, could cause our results and the results of our consolidated subsidiaries to differ materially from those expressed or implied by these forward-looking statements. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including any projections of earnings, revenue or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statement concerning proposed new services or developments; any statements regarding the future economic conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing. The risks, uncertainties and assumptions referred to above include difficulty of managing our growth and integrating our new acquisitions and other risks that are described from time to time in our SEC reports, including but not limited to the items discussed below.

If we are unable to successfully integrate NPC animal hospital operations into our animal hospital operations in a timely and efficient manner, we may incur substantial costs, and our revenue, margins and net income may be adversely affected.

On June 1, 2004, we acquired NPC. Prior to our acquisition, the NPC animal hospitals, as a group, operated at gross profit margins lower than our animal hospitals, and, as a result, we expect our animal hospital margins to be lower than historical amounts for the next several quarters. We entered into the merger agreement with NPC with the expectation that the merger will result in improved operating results and beneficial synergies, such as the realization of improved margins at animal hospitals through a strategy of centralizing various corporate and administrative functions and leveraging fixed costs. Our ability to realize on the benefits of this acquisition is dependent, in part, on achieving these efficiencies and increasing the gross profit margins of the acquired NPC hospitals.

Achieving these anticipated business benefits will depend on whether our operations and NPC s operations are successfully integrated in an efficient, effective and timely manner. Any unanticipated costs or results, or delays or failures in the integration process may negatively impact our combined revenue, margins and net income. The combination of our company and NPC will require, among other things, the retention of key management and professional personnel, including specialists; the integration and expansion of the companies management staff, veterinarians and other professional staff; and the identification and elimination of unnecessary overhead and non-performing hospitals.

The integration of the operations of the combined companies requires the dedication of management resources, which may temporarily detract attention from the day-to-day business of the combined companies. Our field management may spend a predominant amount of time integrating these new hospitals and less time managing our existing hospitals in those regions. In addition, the employees of the combined companies may be less productive as a result of uncertainty during the integration process, which also may disrupt our business. Even if we successfully integrate NPC into our operations, the integration process itself will be accomplished over time and any attention paid to the integration process at the expense of the day-to-day operations and any uncertainty which results from the integration process itself may have an adverse effect on the business and results of operations of the combined companies. We also may experience unanticipated delays in converting the systems of NPC animal hospitals into our systems, which may result in unanticipated increases to payroll expense to collect our results and delays in reporting our results.

In addition, the present and potential customers of the animal hospitals acquired in the NPC merger may not continue their current utilization patterns or, alternatively, the merger and integration process may have an adverse impact on the relationships between those customers and the veterinarians and other animal health care professionals currently employed at the animal hospitals acquired in the NPC merger. Any significant reduction in utilization patterns or any significant adverse impact on relationships between the customers and the veterinarians or other animal health care professionals currently employed at the animal hospitals acquired in the NPC merger may have an adverse effect on the business and results of operations of the combined companies.

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

Our success depends in part on our ability to build on our position as a leading animal health care services company through a balanced program of internal growth initiatives and selective acquisitions of established animal hospitals and laboratories. If we cannot implement or effectively execute these initiatives and acquisitions, our results of operations will be adversely affected. Even if we effectively implement our growth strategy, we may not achieve the economies of scale that we have experienced in the past or that we anticipate having in the future. Our internal growth rate may decline and could become negative. Our laboratory internal revenue growth has fluctuated between 11.9% and 14.1% for each fiscal year from 2001 through 2003. For the three and nine months ended September 30, 2004, our laboratory internal revenue growth was 9.2% and 9.5% respectively, which are both below our historical rates for the prior three years. Our animal hospital same-store revenue growth rate has fluctuated between 3.6% and 5.0% for each fiscal year from 2001 through 2003. For the three and nine months ended September 30, 2004, our animal hospital same-store revenue growth was 2.8% and 4.3% respectively. Our internal growth may continue to fluctuate and may be below our historical rates. Any reductions in the rate of our internal growth may cause our revenues and margins to decrease. Our historical growth rates and margins are not necessarily indicative of future results.

Demand for certain products could decline as their product life cycle matures and the products become available in other channels of distribution such as retail-oriented locations and through internet service providers. This cycle could affect the frequency of veterinary visits and may result in a reduction in revenue. Demand for vaccinations may also be impacted in the future as protocols for vaccinations change. Vaccinations have been recommended by some in the profession to be given less frequently. This may result in fewer visits and potentially less revenue. Vaccine protocols for our company are currently established by our veterinarians. Some of our veterinarians have changed their protocols and others may change their protocol in light of recent literature.

Due to the fixed cost nature of our business, fluctuations in our revenue could adversely affect our operating income.

Approximately 56% of our expense for the year ended December 31, 2003, particularly rent and personnel costs, are fixed costs and are based in part on expectations of revenue. We may be unable to reduce spending in a timely manner to compensate for any significant fluctuations in our revenue. Accordingly, shortfalls in revenue may adversely affect our operating income.

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

Our success depends on our ability to timely and cost-effectively acquire, and integrate into our business, additional animal hospitals and laboratories. Any difficulties in the integration process may result in increased expense, loss of customers and a decline in profitability. We expect to acquire in the ordinary course of business 20 to 25 animal hospitals per year with aggregate annual revenues of approximately $25.0 million. In some cases, we have experienced delays and increased costs in integrating some hospitals, particularly where we acquire a large number of hospitals in a single region at or about the same time. In these cases, our field management may spend a predominant amount of time integrating these new hospitals and less time managing our existing hospitals in those regions. During these periods, there may be less attention directed to marketing efforts or staffing issues. In these circumstances, we also have experienced delays in converting the systems of acquired hospitals into our systems, which results in increased payroll expense to collect our results and delays in reporting our results, both for a particular region and on a consolidated basis. If this were to occur in the future, it could result in decreased revenue, increased costs or lower margins.

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

- negative effects on our operating results;
- impairments of goodwill and other intangible assets;
- dependence on retention, hiring and training of key personnel, including specialists; and
- contingent and latent risks associated with the past operations of, and other unanticipated problems arising in, an acquired business.

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

The carrying value of our goodwill could be subject to impairment write-down.

At September 30, 2004, our balance sheet reflected $481.1 million of goodwill, which was a substantial portion of our total assets of $723.7 million at that date. We expect that the aggregate amount of goodwill on our balance sheet will increase as a result of future acquisitions. We continually evaluate whether events or circumstances have occurred that suggest that the fair market value of each of our reporting units is below their carrying values. If we determine that the fair market value of one of our reporting units is less than its carrying value, this may result in an impairment write-down of the goodwill for that reporting unit. The impairment write-down would be reflected as expense and could have a material adverse effect on our results of operations during the period in which we recognize the expense. At December 31, 2003, we concluded that the fair value of our reporting units exceeded their carrying value and accordingly, as of that date, our net goodwill was not impaired in our consolidated financial statements. However, in the future we may incur impairment charges related to the goodwill already recorded or arising out of future acquisitions.

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

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

At September 30, 2004, our debt consisted of:

- $223.9 million in principal amount outstanding under our senior credit facility;
- $170.0 million in principal amount outstanding under our 9.875% senior subordinated notes; and
- $3.8 million in principal amount outstanding under our other debt.

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

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

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

- limit our funds available to repay the 9.875% senior subordinated notes;
- limit our ability to borrow additional funds or to obtain other financing in the future for working capital, capital expenditures, acquisitions, investments and general corporate purposes;
- limit our ability to dispose of our assets, create liens on our assets or to extend credit;
- make us more vulnerable to economic downturns and reduce our flexibility in responding to changing business and economic conditions;
- limit our flexibility in planning for, or reacting to, changes in our business or industry;
- place us at a competitive disadvantage to our competitors with less debt; and
- restrict our ability to pay dividends, repurchase or redeem our capital stock or debt, or merge or consolidate with another entity.

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

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

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

The significant competition in the companion animal health care services industry could cause us to reduce prices or lose market share.

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

There are many clinical laboratory companies that provide a broad range of laboratory testing services in the same markets we service. Our largest competitor for outsourced laboratory testing services is Idexx Laboratories, Inc., or Idexx. Idexx currently competes or intends to compete in most of the same markets in which we operate. In this regard, Idexx has recently acquired additional laboratories in the markets in which we operate and has announced plans to continue this expansion and aggressively bundles all of their products and services to compete with us. Increased competition may lead to pressures on the revenues and margins of our laboratory operations. Also, Idexx and several other national companies provide on-site diagnostic equipment that allows veterinarians to perform their own laboratory tests.

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

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

As the pet population continues to grow, the need for skilled veterinarians continues to increase. If we are unable to retain an adequate number of skilled veterinarians, we may lose customers, our revenue may decline and we may need to sell or close animal hospitals. As of September 30, 2004, there were 28 veterinary schools in the country accredited by the American Veterinary Medical Association. These schools graduate approximately 2,100 veterinarians per year. There is a shortage of skilled veterinarians in some regional markets in which we operate animal hospitals. During shortages in these regions, we may be unable to hire enough qualified veterinarians to adequately staff our animal hospitals, in which event we may lose market share and our revenues and profitability may decline.

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

The laws of many states prohibit business corporations from providing, or holding themselves out as providers of, veterinary medical care. These laws vary from state to state and are enforced by the courts and by regulatory authorities with broad discretion. As of September 30, 2004, we operated 101 animal hospitals in 12 states with these laws, including 23 in New York and 26 in Texas. We may experience difficulty in expanding our operations into other states with similar laws. Given varying and uncertain interpretations of the veterinary laws of each state, we may not be in compliance with restrictions on the corporate practice of veterinary medicine in all states. A determination that we are in violation of applicable restrictions on the practice of veterinary medicine in any state in which we operate could have a material adverse effect on us, particularly if we were unable to restructure our operations to comply with the requirements of that state.

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

Any failure in our information technology systems or disruption in our transportation network (including disruption resulting from terrorist activities) could significantly increase testing turn-around time, reduce our production capacity and otherwise disrupt our operations.

Our laboratory operations depend, in part, on the continued and uninterrupted performance of our information technology systems and transportation network. Our growth has necessitated continued expansion and upgrade of our information technology systems and transportation network. Sustained system failures or interruption in our transportation network or in one or more of our laboratory operations could disrupt our ability to process laboratory requisitions, perform testing, provide test results in a timely manner and/or bill the appropriate party. We could lose customers and revenue as a result of a system or transportation network failure.

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

In addition, over time we have significantly customized the computer systems in our laboratory business. We rely on a limited number of employees to upgrade and maintain these systems. If we were to lose the services of some or all of these employees, it may be time-consuming for new employees to become familiar with our systems, and we may experience disruptions in service during these periods.

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Any substantial reduction in the number of available flights or delays in the departure of flights, whether as a result of severe weather conditions, a terrorist attack or any other type of disruption, will disrupt our transportation network and our ability to provide test results in a timely manner. Any change in government regulation related to transporting samples or specimens could also have an impact on our business. In addition, our Test Express service, which services customers outside of major metropolitan areas, is dependent on flight services in and out of Memphis and the transportation network of Federal Express. Any sustained interruption in either flight services in Memphis or the transportation network of Federal Express would result in increased turn-around time for the reporting of test results to customers serviced by our Test Express service.

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of September 30, 2004, we had borrowings of $223.9 million under our senior credit facility with fluctuating interest rates based on market benchmarks such as LIBOR. To reduce the risk of increasing interest rates, we have entered into three separate no-fee interest rate swap agreements. The first agreement is for $40.0 million and commenced on November 29, 2002 and expires November 29, 2004. The second agreement is for $20.0 million and commenced on May 30, 2003 and expires May 31, 2005. The third agreement is for $20.0 million and commenced on May 30, 2003 and expires May 31, 2005. These swap agreements have the effect of reducing the amount of our debt exposed to variable interest rates from $223.9 million to $143.9 million. Accordingly, for the twelve-month period ending September 30, 2005, for every 1.0% increase in LIBOR we will pay an additional $1.9 million in interest expense and for every 1.0% decrease in LIBOR we will save $1.9 million in interest expense.

We are considering entering into additional interest rate strategies to take advantage of the current rate environment. We have not yet determined what those strategies may be or their possible impact.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we have carried out an evaluation, 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. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic reports with the SEC.

In accordance with the requirements of the SEC, our Chief Executive Officer and Chief Financial Officer note that, since the date of the most recent evaluation of our disclosure controls and procedures to the date of this quarterly report on Form 10-Q, there have been no significant changes in our internal controls or in other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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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 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

On July 12, 2004, we held our annual meeting of stockholders at which our stockholders:

elected Robert L. Antin as a Class II director;

approved an amendment to our certificate of incorporation to increase the amount of shares of common stock authorized for issuance from 75,000,000 to 175,000,000; and

ratified KPMG LLP as our independent auditor.

The results of the election of one Class II director are as follows:

Candidate	Yes Votes	No Votes	Abstain	Broker Non-Vote
Robert L. Antin	35,059,343		3,677,346	

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

Proposal	Yes Votes	No Votes	Abstain	Broker Non-Vote
Amend certificate of incorporation to increase shares of common stock authorized for issuance from 75,000,000 to 175,000,000	34,878,212	3,847,792	10,685	
Ratify KPMG LLP as our independent auditor	38,709,767	22,480	4,442	

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

(a) Exhibits:

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

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

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

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SIGNATURE

Pursuant to the requirements of 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, in the City of Los Angeles, State of California.

Date: November 5, 2004	By:	/s/ TOMAS W. FULLER
		Tomas W. Fuller Chief Financial Officer

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