

VCA INC

FORM 10-Q (Quarterly Report)

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| | |
|-------------|--|
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| Sector | Healthcare |
| Fiscal Year | 12/31 |

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

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

Commission File Number: 001-16783

VCA Inc.

(Exact name of registrant as specified in its charter)

Delaware

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

95-4097995

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

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

Large accelerated filer [X]

Accelerated filer []

Non-accelerated filer []

Smaller reporting company []

(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: common stock, \$0.001 par value, 80,865,923 shares as of August 1, 2016 .

VCA Inc. and Subsidiaries
Form 10-Q
June 30, 2016

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

| | June 30, 2016 | December 31, 2015 |
|--|----------------------|--------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 109,684 | \$ 98,888 |
| Trade accounts receivable, less allowance for uncollectible accounts of \$22,715 and \$21,775 at June 30, 2016 and December 31, 2015, respectively | 83,157 | 76,634 |
| Inventory | 61,829 | 51,523 |
| Prepaid expenses and other | 36,221 | 30,521 |
| Prepaid income taxes | 1,153 | 24,598 |
| Total current assets | <u>292,044</u> | <u>282,164</u> |
| Property and equipment, net | 564,034 | 507,753 |
| Goodwill | 1,963,377 | 1,517,650 |
| Other intangible assets, net | 257,648 | 97,377 |
| Notes receivable | 2,173 | 2,194 |
| Other | 99,851 | 93,994 |
| Total assets | <u>\$ 3,179,127</u> | <u>\$ 2,501,132</u> |
| Liabilities and Equity | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 25,980 | \$ 33,623 |
| Accounts payable | 53,177 | 52,337 |
| Accrued payroll and related liabilities | 80,817 | 75,519 |
| Other accrued liabilities | 81,907 | 70,828 |
| Total current liabilities | <u>241,881</u> | <u>232,307</u> |
| Long-term debt, net | 1,279,453 | 832,718 |
| Deferred income taxes, net | 130,209 | 131,478 |
| Other liabilities | 39,236 | 36,084 |
| Total liabilities | <u>1,690,779</u> | <u>1,232,587</u> |
| Commitments and contingencies | | |
| Redeemable noncontrolling interests | 12,053 | 11,511 |
| Preferred stock, par value \$0.001, 11,000 shares authorized, none outstanding | — | — |
| VCA Inc. stockholders' equity: | | |
| Common stock, par value \$0.001, 175,000 shares authorized, 80,863 and 80,764 shares outstanding as of June 30, 2016 and December 31, 2015, respectively | 81 | 81 |
| Additional paid-in capital | 28,696 | 19,708 |
| Retained earnings | 1,385,484 | 1,275,207 |
| Accumulated other comprehensive loss | (37,827) | (50,034) |
| Total VCA Inc. stockholders' equity | <u>1,376,434</u> | <u>1,244,962</u> |
| Noncontrolling interests | 99,861 | 12,072 |
| Total equity | <u>1,476,295</u> | <u>1,257,034</u> |
| Total liabilities and equity | <u>\$ 3,179,127</u> | <u>\$ 2,501,132</u> |

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

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------------|------------------------------|--------------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue | \$ 653,489 | \$ 548,785 | \$ 1,216,928 | \$ 1,048,238 |
| Direct costs | 489,541 | 407,938 | 916,200 | 793,529 |
| Gross profit | 163,948 | 140,847 | 300,728 | 254,709 |
| Selling, general and administrative expense | 48,190 | 44,485 | 98,318 | 88,883 |
| Net (gain) loss on sale or disposal of assets | (271) | (819) | 292 | (484) |
| Operating income | 116,029 | 97,181 | 202,118 | 166,310 |
| Interest expense, net | 7,867 | 5,104 | 14,962 | 9,941 |
| Debt retirement costs | 1,600 | — | 1,600 | — |
| Other (income) expense | (600) | (37) | (864) | 29 |
| Income before provision for income taxes | 107,162 | 92,114 | 186,420 | 156,340 |
| Provision for income taxes | 40,736 | 36,191 | 72,272 | 60,864 |
| Net income | 66,426 | 55,923 | 114,148 | 95,476 |
| Net income attributable to noncontrolling interests | 2,376 | 1,624 | 3,871 | 2,876 |
| Net income attributable to VCA Inc. | \$ 64,050 | \$ 54,299 | \$ 110,277 | \$ 92,600 |
| Basic earnings per share | \$ 0.79 | \$ 0.66 | \$ 1.36 | \$ 1.13 |
| Diluted earnings per share | \$ 0.78 | \$ 0.65 | \$ 1.35 | \$ 1.11 |
| Weighted-average shares outstanding for basic earnings per share | 80,835 | 81,956 | 80,806 | 82,150 |
| Weighted-average shares outstanding for diluted earnings per share | 81,729 | 83,084 | 81,630 | 83,227 |

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

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------------------|------------------------------|------------------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income ⁽¹⁾ | \$ 66,426 | \$ 55,923 | \$ 114,148 | \$ 95,476 |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustments | 32 | 4,411 | 12,630 | (11,269) |
| Other comprehensive income (loss) | 32 | 4,411 | 12,630 | (11,269) |
| Total comprehensive income | 66,458 | 60,334 | 126,778 | 84,207 |
| Comprehensive income attributable to noncontrolling interests ⁽¹⁾ | 2,446 | 1,761 | 4,294 | 2,541 |
| Comprehensive income attributable to VCA Inc. | <u>\$ 64,012</u> | <u>\$ 58,573</u> | <u>\$ 122,484</u> | <u>\$ 81,666</u> |

⁽¹⁾ Includes approximately \$2.1 million and \$1.6 million of net income related to redeemable and mandatorily redeemable noncontrolling interests for the six months ended June 30, 2016 and 2015, respectively.

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

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

| | Common Stock | | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income | Noncontrolling Interests | Total |
|---|---------------|--------------|----------------------------------|----------------------|---|-----------------------------|--------------------|
| | Shares | Amount | | | | | |
| Balances, December 31, 2014 | 82,937 | \$ 83 | \$ 155,802 | \$1,064,158 | \$ (19,397) | \$ 10,975 | \$1,211,621 |
| Net income (excludes \$877 and \$749 related to redeemable and mandatorily redeemable noncontrolling interests, respectively) | — | — | — | 92,600 | — | 1,250 | 93,850 |
| Other comprehensive loss (excludes \$136 related to mandatorily redeemable noncontrolling interests) | — | — | — | — | (10,934) | (199) | (11,133) |
| Formation of noncontrolling interests | — | — | — | — | — | (14) | (14) |
| Distribution to noncontrolling interests | — | — | — | — | — | (1,118) | (1,118) |
| Purchase of noncontrolling interests | — | — | (217) | — | — | (473) | (690) |
| Share-based compensation | — | — | 8,269 | — | — | — | 8,269 |
| Issuance of common stock under stock incentive plans | 376 | — | 679 | — | — | — | 679 |
| Stock repurchases | (1,865) | (2) | (96,672) | — | — | — | (96,674) |
| Excess tax benefit from share-based compensation | — | — | 4,729 | — | — | — | 4,729 |
| Balances, June 30, 2015 | <u>81,448</u> | <u>\$ 81</u> | <u>\$ 72,590</u> | <u>\$1,156,758</u> | <u>\$ (30,331)</u> | <u>\$ 10,421</u> | <u>\$1,209,519</u> |
| Balances, December 31, 2015 | 80,764 | \$ 81 | \$ 19,708 | \$1,275,207 | \$ (50,034) | \$ 12,072 | \$1,257,034 |
| Net income (excludes \$1,300 and \$827 related to redeemable and mandatorily redeemable noncontrolling interests, respectively) | — | — | — | 110,277 | — | 1,744 | 112,021 |
| Other comprehensive income (excludes \$168 related to mandatorily redeemable noncontrolling interests) | — | — | — | — | 12,207 | 255 | 12,462 |
| Formation of noncontrolling interests | — | — | — | — | — | 88,949 | 88,949 |
| Distribution to noncontrolling interests | — | — | — | — | — | (1,166) | (1,166) |
| Purchase of noncontrolling interests | — | — | (1,822) | — | — | (1,908) | (3,730) |
| Share-based compensation | — | — | 9,104 | — | — | — | 9,104 |
| Issuance of common stock under stock incentive plans | 117 | — | 1,122 | — | — | — | 1,122 |
| Stock repurchases | (18) | — | (843) | — | — | — | (843) |
| Excess tax benefit from share-based compensation | — | — | 1,421 | — | — | — | 1,421 |
| Other | — | — | 6 | — | — | (85) | (79) |
| Balances, June 30, 2016 | <u>80,863</u> | <u>\$ 81</u> | <u>\$ 28,696</u> | <u>\$1,385,484</u> | <u>\$ (37,827)</u> | <u>\$ 99,861</u> | <u>\$1,476,295</u> |

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

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

| | Six Months Ended June 30, | |
|--|--------------------------------------|-------------|
| | 2016 | 2015 |
| Cash flows from operating activities: | | |
| Net income | \$ 114,148 | \$ 95,476 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 46,978 | 40,163 |
| Amortization of debt issue costs | 865 | 870 |
| Provision for uncollectible accounts | 2,891 | 3,379 |
| Debt retirement costs | 1,600 | — |
| Net loss (gain) on sale or disposal of assets | 292 | (484) |
| Share-based compensation | 9,104 | 8,269 |
| Excess tax benefits from share-based compensation | (1,421) | (4,729) |
| Other | 6,665 | (658) |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | (7,065) | (24,217) |
| Inventory, prepaid expenses and other assets | (15,607) | (8,942) |
| Accounts payable and other accrued liabilities | 5,889 | (4,196) |
| Accrued payroll and related liabilities | 2,817 | 8,300 |
| Income taxes | 23,557 | 16,525 |
| Net cash provided by operating activities | 190,713 | 129,756 |
| Cash flows from investing activities: | | |
| Business acquisitions, net of cash acquired | (540,878) | (66,529) |
| Property and equipment additions | (58,814) | (34,521) |
| Proceeds from sale or disposal of assets | 282 | 6,164 |
| Other | (4,924) | 205 |
| Net cash used in investing activities | (604,334) | (94,681) |
| Cash flows from financing activities: | | |
| Repayment of long-term obligations | (1,256,250) | (7,924) |
| Proceeds from issuance of long-term obligations | 1,255,000 | — |
| Proceeds from revolving credit facility | 435,000 | 61,000 |
| Payment of financing costs | (3,829) | — |
| Distribution to noncontrolling interests | (2,554) | (2,447) |
| Purchase of noncontrolling interests | (3,730) | (1,493) |
| Proceeds from issuance of common stock under stock incentive plans | 1,122 | 679 |
| Excess tax benefits from share-based compensation | 1,421 | 4,729 |
| Stock repurchases | (843) | (96,674) |
| Other | (1,233) | (80) |
| Net cash provided by (used in) financing activities | 424,104 | (42,210) |
| Effect of currency exchange rate changes on cash and cash equivalents | 313 | 78 |
| Increase (decrease) in cash and cash equivalents | 10,796 | (7,057) |
| Cash and cash equivalents at beginning of period | 98,888 | 81,383 |
| Cash and cash equivalents at end of period | \$ 109,684 | \$ 74,326 |

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

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

| | Six Months Ended | |
|--|-------------------------|-------------|
| | June 30, | |
| | 2016 | 2015 |
| Supplemental disclosures of cash flow information: | | |
| Interest paid | \$ 12,272 | \$ 8,907 |
| Income taxes paid | \$ 47,326 | \$ 44,253 |

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

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements
June 30, 2016
(Unaudited)

1. Nature of Operations

Our company, VCA Inc. ("VCA") is a Delaware corporation formed in 1986 and is based in Los Angeles, California. We are an animal healthcare company with the following four operating segments: animal hospitals ("Animal Hospital"), veterinary diagnostic laboratories ("Laboratory"), veterinary medical technology ("Medical Technology"), and Camp Bow Wow Franchising, Inc. (f/k/a D.O.G. Enterprises, LLC ("Camp Bow Wow")). Our operating segments are aggregated into two reportable segments: Animal Hospital and Laboratory. Our Medical Technology and Camp Bow Wow operating segments are combined in our All Other category. See *Note 8, Lines of Business* within these notes to unaudited condensed, consolidated financial statements.

Our Animal Hospitals offer a full range of general medical and surgical services for companion animals. Our Animal Hospitals treat diseases and injuries, provide pharmaceutical products and perform a variety of pet-wellness programs, including health examinations, diagnostic testing, vaccinations, spaying, neutering and dental care. At June 30, 2016, we operated or managed 767 animal hospitals throughout 43 states and five Canadian provinces.

We operate a full-service veterinary diagnostic laboratory network serving all 50 states and certain areas in Canada. Our Laboratory network provides sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. At June 30, 2016, we operated 60 laboratories of various sizes located strategically throughout the United States and Canada.

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

Our Camp Bow Wow business franchises a premier provider of pet services including dog day care, overnight boarding, grooming and other ancillary services at specially designed pet care facilities, principally under the trademark Camp Bow Wow[®]. As of June 30, 2016, there were 129 Camp Bow Wow franchise locations operating in 34 states and one Canadian province.

On December 31, 2015, our company sold substantially all of the assets of Vetstreet Inc. ("Vetstreet") to a subsidiary of Henry Schein, Inc.. Concurrent with the sale of Vetstreet, we purchased a 19.9% interest in the continuing Vetstreet business. Prior to the sale of Vetstreet, its results of operations were included in our "All Other" category.

On May 1, 2016, we acquired an 80% ownership interest in Companion Animal Practices, North America ("CAPNA"). CAPNA, founded in 2010, is located in Las Vegas, Nevada and operates a network of 56 free standing animal hospitals in 18 states. CAPNA's results of operations are included in our Animal Hospital segment.

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

2. Basis of Presentation

Our accompanying unaudited, condensed, consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") for interim financial information and in accordance with the rules and regulations of the United States Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements as permitted under applicable rules and regulations. In the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included. The results of operations for the six months ended June 30, 2016 are not necessarily indicative of the results to be expected for the full year ending December 31, 2016. For further information, refer to our audited consolidated financial statements and notes thereto included in our 2015 Annual Report on Form 10-K.

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

2. Basis of Presentation, continued

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

3. Goodwill and Other Long-Lived Assets

Goodwill

The following table presents the changes in the carrying amount of our goodwill for the six months ended June 30, 2016 (in thousands):

| | Animal Hospital | Laboratory | All Other | Total |
|---------------------------------|----------------------------|-------------------|------------------|---------------------|
| Balance as of December 31, 2015 | | | | |
| Goodwill | \$ 1,402,106 | \$ 101,269 | \$ 144,332 | \$ 1,647,707 |
| Accumulated impairment losses | — | — | (130,057) | (130,057) |
| Subtotal | 1,402,106 | 101,269 | 14,275 | 1,517,650 |
| Goodwill acquired | 434,323 | — | 512 | 434,835 |
| Foreign translation adjustment | 9,034 | 32 | — | 9,066 |
| Other ⁽¹⁾ | 1,826 | — | — | 1,826 |
| Balance as of June 30, 2016 | | | | |
| Goodwill | 1,847,289 | 101,301 | 144,844 | 2,093,434 |
| Accumulated impairment losses | — | — | (130,057) | (130,057) |
| Subtotal | <u>\$ 1,847,289</u> | <u>\$ 101,301</u> | <u>\$ 14,787</u> | <u>\$ 1,963,377</u> |

⁽¹⁾ "Other" consists primarily of measurement period adjustments.

Other Intangible Assets

Our acquisition related amortizable intangible assets at June 30, 2016 and December 31, 2015 are as follows (in thousands):

| | As of June 30, 2016 | | | As of December 31, 2015 | | |
|--|--------------------------------------|-------------------------------------|------------------------------------|--------------------------------------|-------------------------------------|------------------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Non-contractual customer relationships | \$ 265,385 | \$ (61,093) | \$ 204,292 | \$ 116,082 | \$ (48,821) | \$ 67,261 |
| Covenants not-to-compete | 20,785 | (6,083) | 14,702 | 12,435 | (4,779) | 7,656 |
| Favorable lease assets | 9,461 | (5,644) | 3,817 | 9,441 | (5,440) | 4,001 |
| Technology | 1,377 | (697) | 680 | 1,377 | (589) | 788 |
| Trademarks | 25,866 | (5,328) | 20,538 | 10,551 | (4,086) | 6,465 |
| Franchise rights | 11,730 | (2,151) | 9,579 | 11,730 | (1,564) | 10,166 |
| Total | <u>\$ 334,604</u> | <u>\$ (80,996)</u> | <u>\$ 253,608</u> | <u>\$ 161,616</u> | <u>\$ (65,279)</u> | <u>\$ 96,337</u> |

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

3. Goodwill and Other Long-Lived Assets, continued

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------------------------|--------------------------------|----------|------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Aggregate amortization expense | \$ 9,798 | \$ 5,858 | \$ 16,026 | \$ 11,384 |

The estimated amortization expense related to acquisition related intangible assets for the remainder of 2016 and each of the succeeding years thereafter, as of June 30, 2016, is as follows (in thousands):

| | |
|-------------------------------------|------------|
| Finite-lived intangible assets: | |
| Remainder of 2016 | \$ 21,950 |
| 2017 | 39,150 |
| 2018 | 35,719 |
| 2019 | 32,723 |
| 2020 | 27,868 |
| Thereafter | 96,198 |
| Total | \$ 253,608 |
| Indefinite-lived intangible assets: | |
| Trademarks | 4,040 |
| Total intangible assets | \$ 257,648 |

4. Acquisitions

The table below reflects the activity related to the acquisitions and dispositions of our animal hospitals and laboratories during the six months ended June 30, 2016 and 2015, respectively:

| | Six Months Ended June 30, | |
|--------------------------|------------------------------|------|
| | 2016 | 2015 |
| Animal Hospitals: | | |
| Acquisitions | 93 | 23 |
| Acquisitions, merged | (3) | (2) |
| Sold, closed or merged | (5) | (7) |
| Net increase | 85 | 14 |
| Laboratories: | | |
| Acquisitions | — | 1 |
| Acquisitions, merged | — | (1) |
| Net increase | — | — |

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

4. Acquisitions, continued

Animal Hospital and Laboratory Acquisitions

The purchase price allocations for some of the 2016 animal hospital acquisitions included in the table below are preliminary; however, adjustments, if any, are not expected to be material. The measurement periods for purchase price allocations do not exceed 12 months from the acquisition date. The following table summarizes the aggregate consideration for our independent animal hospitals and labs acquired during the six months ended June 30, 2016 and 2015, respectively, (in thousands):

| | Six Months Ended June 30, | |
|---|--------------------------------------|------------------|
| | 2016 | 2015 |
| Consideration: | | |
| Cash | \$ 188,329 | \$ 66,229 |
| Cash acquired | (970) | — |
| Cash, net of cash acquired | \$ 187,359 | \$ 66,229 |
| Assumed debt | 2,601 | 6,250 |
| Holdbacks | 4,148 | 2,522 |
| Earn-outs | 4,002 | — |
| Fair value of total consideration transferred | <u>\$ 198,110</u> | <u>\$ 75,001</u> |
| Allocation of the Purchase Price: | | |
| Tangible assets | \$ 21,521 | \$ 5,064 |
| Identifiable intangible assets ⁽¹⁾ | 24,325 | 24,144 |
| Goodwill ⁽²⁾ | 153,012 | 46,440 |
| Other liabilities assumed | (437) | (647) |
| Fair value of assets acquired and liabilities assumed | \$ 198,421 | \$ 75,001 |
| Noncontrolling interest | (311) | — |
| Total | <u>\$ 198,110</u> | <u>\$ 75,001</u> |

(1) Identifiable intangible assets include customer relationships, trademarks and covenants-not-to-compete. The weighted-average amortization period for the total identifiable intangible assets is approximately five years. The weighted-average amortization period for customer relationships, trademarks and covenants is approximately five years, seven years and five years, respectively.

(2) We expect that \$146.9 million and \$35.5 million of the goodwill recorded for these acquisitions, as of June 30, 2016 and 2015, respectively, will be fully deductible for income tax purposes.

Included in the table above is Antech Diagnostics, Inc.'s March 31, 2015 acquisition of Abaxis Veterinary Reference Laboratory ("AVRL") for total consideration of \$21.0 million.

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

4. Acquisitions, continued

CAPNA Acquisition

On May 1, 2016, we acquired an 80% ownership interest in CAPNA for a preliminary purchase price of \$351.1 million. CAPNA, founded in 2010, is located in Las Vegas, Nevada and at the time of its acquisition, operated a network of 56 free standing animal hospitals in 18 states.

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

| | | |
|---|----|----------|
| Consideration: | | |
| Cash | \$ | 353,554 |
| Cash acquired | | (3,405) |
| Cash, net of cash acquired | \$ | 350,149 |
| Holdbacks | | 1,000 |
| Fair value of total consideration transferred | \$ | 351,149 |
| Allocation of the Purchase Price: | | |
| Tangible assets | \$ | 13,548 |
| Identifiable intangible assets ⁽¹⁾ | | 147,500 |
| Goodwill ⁽²⁾ | | 281,311 |
| Other liabilities assumed | | (2,572) |
| Fair value of assets acquired and liabilities assumed | \$ | 439,787 |
| Noncontrolling interest | | (88,638) |
| Total | \$ | 351,149 |

(1) Identifiable intangible assets primarily include customer relationships, trademarks and covenants-not-to-compete. The weighted-average amortization period for the total identifiable intangible assets is approximately nine years. The amortization periods for customer relationships, trademarks and covenants is ten years, five years and five years, respectively.

(2) As of June 30, 2016, we expect that \$225.0 million of goodwill recorded for this acquisition will be deductible for income tax purposes.

The purchase price allocation for CAPNA is preliminary and is pending the valuation of certain items including, but not limited to, tangible and intangible assets, capital leases, operating leases, deferred income taxes and the noncontrolling interest. The final valuation of the net assets acquired, liabilities assumed and noncontrolling interest is expected to be completed as soon as practicable, but no later than one year from the date of acquisition.

Pro Forma Information

The following pro forma financial information for the three and six months ended June 30, 2016 and 2015 presents (i) the actual results of operations of our 2016 acquisitions and (ii) the combined results of operations for our company and our 2016 acquisitions as if those acquisitions had been completed on April 1, 2015 and January 1, 2015, the first day of the comparable prior reporting periods, respectively. The pro forma financial information considers principally (i) our company's financial results, (ii) the historical financial results of our acquisitions, and (iii) select pro forma adjustments to the historical financial results of our acquisitions. Such pro forma adjustments represent principally estimates of (i) the impact of the hypothetical

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

4. Acquisitions, continued

amortization of acquired intangible assets, (ii) the recognition of fair value adjustments relating to tangible assets, (iii) adjustments reflecting the new capital structure, including additional financing or repayments of debt as part of the acquisitions and (iv) the tax effects of the acquisitions and related adjustments as if those acquisitions had been completed on April 1, 2015 and January 1, 2015. The pro forma financial information is not necessarily indicative of what our consolidated results of operations would have been had we completed the acquisition at the beginning of the comparable prior reporting periods.

In addition, the pro forma financial information does not attempt to project the future results of operations of our company:

| | Revenue | Net Income |
|--|--------------|------------|
| (In thousands): | | |
| Results of acquired businesses included in our three months ended | | |
| June 30, 2016 actuals | \$ 57,148 | \$ 3,864 |
| 2016 supplemental pro forma from April 1, 2016 to June 30, 2016 ⁽¹⁾ | \$ 670,796 | \$ 64,324 |
| 2015 supplemental pro forma from April 1, 2015 to June 30, 2015 ⁽¹⁾ | \$ 624,277 | \$ 57,579 |
| Results of acquired businesses included in our six months ended | | |
| June 30, 2016 actuals | \$ 68,776 | \$ 4,749 |
| 2016 supplemental pro forma from January 1, 2016 to June 30, 2016 ⁽²⁾ | \$ 1,293,470 | \$ 112,222 |
| 2015 supplemental pro forma from January 1, 2015 to June 30, 2015 ⁽²⁾ | \$ 1,205,712 | \$ 97,319 |

(1) 2016 supplemental pro forma net income attributable to VCA was adjusted to exclude \$0.2 million of acquisition-related costs incurred during the three months ended June 30, 2016. 2015 supplemental pro forma net income attributable to VCA was adjusted to include these charges.

(2) 2016 supplemental pro forma net income attributable to VCA was adjusted to exclude \$1.2 million of acquisition-related costs incurred during the six months ended June 30, 2016. 2015 supplemental pro forma net income attributable to VCA was adjusted to include these charges.

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

5. Other Accrued Liabilities

Other accrued liabilities consisted of the following at June 30, 2016 and December 31, 2015 (in thousands):

| | June 30, 2016 | December 31, 2015 |
|--|----------------------|--------------------------|
| Deferred revenue | \$ 16,645 | \$ 14,647 |
| Holdbacks and earn-outs | 13,674 | 9,959 |
| Accrued other insurance | 5,950 | 5,013 |
| Deferred rent | 5,371 | 4,791 |
| Accrued health insurance | 5,014 | 4,952 |
| Miscellaneous accrued taxes ⁽¹⁾ | 5,001 | 3,317 |
| Accrued workers' compensation | 4,019 | 3,212 |
| Accrued accounting and legal fees | 3,415 | 2,697 |
| Customer deposits | 1,966 | 2,971 |
| Accrued lease payments | 1,988 | 1,536 |
| Other | 18,864 | 17,733 |
| | <u>\$ 81,907</u> | <u>\$ 70,828</u> |

⁽¹⁾ Includes property, sales and use taxes.

6. Long-Term Obligations

New Senior Credit Facility

On June 29, 2016 we entered into a new senior credit facility with various lenders for approximately \$1.7 billion of senior secured credit facilities with Bank of America, N.A., as the administrative agent, swingline lender and Letter of Credit issuer, and JPMorgan Chase Bank, N.A., Barclays Bank PLC, Suntrust Bank, and Wells Fargo Bank, National Association as co-syndication agents (the "New Senior Credit Facility"). The New Senior Credit Facility replaced our previous senior credit facility which provided for \$600 million of term notes and an \$800 million revolving credit facility. The New Senior Credit Facility provides for \$880 million of senior secured term notes and an \$800 million senior secured revolving facility, which may be used to borrow, on a same-day notice under a swing line, the lesser of \$25 million and the aggregate unused amount of the revolving credit facility then in effect. In addition to refinancing all outstanding amounts under our previous senior credit facility, borrowings under our New Senior Credit Facility may be used for general corporate purchases, including permitted share repurchases. At June 30, 2016, we had \$375 million in outstanding borrowings under the new senior secured revolving facility, which funds were used together with the proceeds from the \$880 million of new senior secured term notes to refinance amounts outstanding under our previous senior credit facility.

In connection with the New Senior Credit Facility, we incurred \$3.8 million in financing costs, of which approximately \$3.2 million were capitalized as deferred financing costs. The remaining \$0.6 million of financing costs were expensed as debt retirement costs, along with an additional \$1.0 million of previously capitalized deferred financing costs associated with lenders under our previous senior credit facility who are not lenders under our New Senior Credit Facility.

During the current fiscal year, ASU 2015-03 and ASU 2015-15 were adopted. In accordance with ASU 2015-03, the table below presents debt issuance costs as a direct deduction from the face amount of the corresponding notes in the current period and retrospectively in the prior fiscal year end.

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

6. Long-Term Obligations, continued

Long-term obligations consisted of the following at June 30, 2016 and December 31, 2015 (in thousands):

| | | June 30, 2016 | December 31, 2015 |
|----------------------------|--|----------------------|--------------------------|
| <i>Senior term notes</i> | Principal amount | \$ 880,000 | \$ 585,000 |
| | Less unamortized debt issuance costs | (2,937) | (2,408) |
| | Senior term notes less unamortized debt issuance costs, secured by assets, variable interest rate (2.22% and 1.92% at June 30, 2016 and December 31, 2015, respectively) ⁽¹⁾ | \$ 877,063 | \$ 582,592 |
| <i>Revolving credit</i> | Principal amount | \$ 375,000 | \$ 232,000 |
| | Less unamortized debt issuance costs | (4,549) | (3,725) |
| | Revolving line of credit less unamortized debt issuance costs, secured by assets, variable interest rate (2.24% and 1.92% at June 30, 2016 and December 31, 2015, respectively) ⁽¹⁾ | \$ 370,451 | \$ 228,275 |
| <i>Secured seller note</i> | Notes payable matures in 2016, secured by assets and stock of certain subsidiaries, with interest rate of 10.0% | 230 | 230 |
| | Total debt obligations | 1,247,744 | 811,097 |
| | Capital lease obligations and other debt | 57,689 | 55,244 |
| | | 1,305,433 | 866,341 |
| | Less — current portion | (25,980) | (33,623) |
| | | <u>\$ 1,279,453</u> | <u>\$ 832,718</u> |

(1) Notes payable and the revolving line of credit at June 30, 2016 mature in 2021 under the New Senior Credit Facility. Notes payable and the revolving line of credit at December 31, 2015 were due to mature in 2019 under the previous senior credit facility dated August 27, 2014.

Interest Rate. In general, borrowings under the New Senior Credit Facility (including swing line borrowings) bear interest, at our option, on either:

- the base rate (as defined below) plus the applicable margin of 0.75% (Pricing Tier 2, see table below) per annum; or
- the Eurodollar rate (as defined below), plus a margin of 1.75% (Pricing Tier 2, see table below) per annum

Each of the aforementioned margins remain applicable until the date of delivery of the compliance certificate and the financial statements, for the period ended September 30, 2016, at which time the applicable margin will be determined by reference to the leverage ratio in effect from time to time as set forth in the following table:

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

6. Long-Term Obligations, continued

| Pricing Tier | Consolidated Leverage Ratio | Applicable Margin for Eurodollar Loans/Letter of Credit Fees | Applicable Margin for Base Rate Loans | Commitment Fee |
|--------------|-----------------------------|---|--|----------------|
| 1 | ≥ 3.50:1.00 | 2.00% | 1.00% | 0.40% |
| 2 | < 3.50:1.00 and ≥ 2.75:1.00 | 1.75% | 0.75% | 0.35% |
| 3 | < 2.75:1.00 and ≥ 1.75:1.00 | 1.50% | 0.50% | 0.30% |
| 4 | < 1.75:1.00 and ≥ 1.00:1.00 | 1.25% | 0.25% | 0.25% |
| 5 | < 1.00:1.00 | 1.00% | —% | 0.25% |

The base rate for the senior term notes is a rate per annum equal to the highest of the (a) Federal Funds Rate plus 0.5%, (b) Bank of America, N.A.'s ("Bank of America") prime rate in effect on such day, and (c) the Eurodollar rate plus 1.0%. The Eurodollar rate is defined as the rate per annum equal to the London Interbank Offered Rate ("LIBOR"), or a comparable or successor rate which is approved by Bank of America.

Maturity and Principal Payments. The senior term notes mature on June 29, 2021. Principal payments on the senior term notes of \$5.5 million are due each calendar quarter from September 30, 2016 to and including June 30, 2017, \$11.0 million are due each calendar quarter from September 30, 2017 to and including June 30, 2019, \$16.5 million are due each calendar quarter from September 30, 2019 to and including June 30, 2020 and \$22.0 million are due each calendar quarter thereafter with a final payment of the outstanding principal balance due upon maturity.

The revolving credit facility has a per annum commitment fee determined by reference to the Leverage Ratio in effect from time to time and is applied to the unused portion of the commitment. The revolving credit facility matures on June 29, 2021. Principal payments on the revolving credit facility are made at our discretion with the entire unpaid amount due at maturity. At June 30, 2016, we had borrowings of \$375.0 million under our revolving credit facility.

The following table sets forth the scheduled principal payments for our senior credit facility (in thousands):

| | 2016 | 2017 | 2018 | 2019 | 2020 | Thereafter |
|-------------------|------------------|------------------|------------------|------------------|------------------|---------------------|
| Senior term notes | \$ 11,000 | \$ 33,000 | \$ 44,000 | \$ 55,000 | \$ 77,000 | \$ 660,000 |
| Revolving loans | — | — | — | — | — | 375,000 |
| | <u>\$ 11,000</u> | <u>\$ 33,000</u> | <u>\$ 44,000</u> | <u>\$ 55,000</u> | <u>\$ 77,000</u> | <u>\$ 1,035,000</u> |

Guarantees and Security. We and each of our wholly-owned domestic subsidiaries guarantee the outstanding indebtedness under the New Senior Credit Facility. Any borrowings, along with the guarantees of the domestic subsidiaries, are further secured by a pledge of substantially all of our consolidated assets, including 65% of the voting equity and 100% of the non-voting equity interest in each of our foreign subsidiaries.

Debt Covenants. The New Senior Credit Facility contains certain financial covenants pertaining to interest coverage and leverage ratios. In addition, the New Senior Credit Facility has restrictions pertaining to the payment of cash dividends on all classes of stock. At June 30, 2016, we had an interest coverage ratio of 19.09 to 1.00, which was in compliance with the required ratio of no less than 3.00 to 1.00, and a leverage ratio of 2.68 to 1.00, which was in compliance with the required ratio of no more than 4.00 to 1.00.

7. Calculation of Earnings per Share

Basic earnings per share is calculated by dividing net income by the weighted-average number of shares outstanding during the period. Diluted earnings per share is calculated by dividing net income attributable to VCA Inc. by the weighted-

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

7. Calculation of Earnings per Share, continued

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--|-------------|--------------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income attributable to VCA Inc. | \$ 64,050 | \$ 54,299 | \$ 110,277 | \$ 92,600 |
| Weighted-average common shares outstanding: | | | | |
| Basic | 80,835 | 81,956 | 80,806 | 82,150 |
| Effect of dilutive potential common shares: | | | | |
| Stock options | 295 | 334 | 294 | 337 |
| Non-vested shares and units | 599 | 794 | 530 | 740 |
| Diluted | 81,729 | 83,084 | 81,630 | 83,227 |
| Basic earnings per common share | \$ 0.79 | \$ 0.66 | \$ 1.36 | \$ 1.13 |
| Diluted earnings per common share | \$ 0.78 | \$ 0.65 | \$ 1.35 | \$ 1.11 |

For the three months ended June 30, 2016 , there were 21,122 potential shares excluded from the computation of diluted earnings per share because their inclusion would have had an antidilutive effect. There were no potential common shares excluded from the computation of diluted earnings per share for the three months ended June 30, 2015 .

For the six months ended June 30, 2016 and 2015, potential common shares of 24,047 and 38,120 , respectively, were excluded from the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

8. Lines of Business

Our Animal Hospital and Laboratory business segments are each considered reportable segments in accordance with the FASB's guidance related to Segment Reporting. Our Animal Hospital segment provides veterinary services for companion animals and sells related retail and pharmaceutical products. Our Laboratory segment provides diagnostic laboratory testing services for veterinarians, both associated with our animal hospitals and those independent of us. Our other operating segments included in the "All Other" category in the following tables are our Medical Technology business, which sells digital radiography and ultrasound imaging equipment, related computer hardware, software and ancillary services to the veterinary market, and our Camp Bow Wow business, which primarily franchises a premier provider of pet services including dog day care, overnight boarding, grooming and other ancillary services at specially designed pet care facilities. These operating segments do not meet the quantitative requirements for reportable segments. Our operating segments are strategic business units that have different services, products and/or functions. The segments are managed separately because each is a distinct and different business venture with unique challenges, risks and rewards. We also operate a corporate office that provides general and administrative support services for our other segments.

The accounting policies of our segments are the same as those described in the summary of significant accounting policies included in our 2015 Annual Report on Form 10-K. We evaluate the performance of our segments based on gross profit and operating income. For purposes of reviewing the operating performance of our segments, all intercompany sales and purchases are generally accounted for as if they were transactions with independent third parties at current market prices.

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

8. Lines of Business, continued

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

| | Animal Hospital | Laboratory | All Other | Corporate | Eliminations | Total |
|---|----------------------------|-------------------|------------------|------------------|---------------------|--------------|
| Three Months Ended June 30, 2016 | | | | | | |
| External revenue | \$ 540,376 | \$ 93,265 | \$ 18,656 | \$ — | \$ 1,192 | \$ 653,489 |
| Intercompany revenue | — | 18,795 | 4,741 | — | (23,536) | — |
| Total revenue | 540,376 | 112,060 | 23,397 | — | (22,344) | 653,489 |
| Direct costs | 445,697 | 51,513 | 14,480 | — | (22,149) | 489,541 |
| Gross profit | 94,679 | 60,547 | 8,917 | — | (195) | 163,948 |
| Selling, general and administrative expense | 14,277 | 9,702 | 6,022 | 18,189 | — | 48,190 |
| Operating income (loss) before sale or disposal of assets | 80,402 | 50,845 | 2,895 | (18,189) | (195) | 115,758 |
| Net (gain) loss on sale or disposal of assets | (132) | (35) | 3 | (107) | — | (271) |
| Operating income (loss) | \$ 80,534 | \$ 50,880 | \$ 2,892 | \$ (18,082) | \$ (195) | \$ 116,029 |
| Depreciation and amortization | \$ 21,875 | \$ 2,839 | \$ 904 | \$ 668 | \$ (597) | \$ 25,689 |
| Property and equipment additions | \$ 25,486 | \$ 4,750 | \$ 1,485 | \$ 2,336 | \$ (1,049) | \$ 33,008 |
| Three Months Ended June 30, 2015 | | | | | | |
| External revenue | \$ 435,376 | \$ 89,707 | \$ 22,818 | \$ — | \$ 884 | \$ 548,785 |
| Intercompany revenue | — | 16,515 | 5,851 | — | (22,366) | — |
| Total revenue | 435,376 | 106,222 | 28,669 | — | (21,482) | 548,785 |
| Direct costs | 361,991 | 49,519 | 17,280 | — | (20,852) | 407,938 |
| Gross profit | 73,385 | 56,703 | 11,389 | — | (630) | 140,847 |
| Selling, general and administrative expense | 10,453 | 9,487 | 7,741 | 16,804 | — | 44,485 |
| Operating income (loss) before sale or disposal of assets | 62,932 | 47,216 | 3,648 | (16,804) | (630) | 96,362 |
| Net (gain) loss on sale or disposal of assets | (914) | 35 | 11 | 49 | — | (819) |
| Operating income (loss) | \$ 63,846 | \$ 47,181 | \$ 3,637 | \$ (16,853) | \$ (630) | \$ 97,181 |
| Depreciation and amortization | \$ 16,440 | \$ 2,705 | \$ 1,176 | \$ 575 | \$ (530) | \$ 20,366 |
| Property and equipment additions | \$ 13,995 | \$ 2,862 | \$ 500 | \$ 1,512 | \$ (874) | \$ 17,995 |

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

8. Lines of Business, continued

| | Animal Hospital | Laboratory | All Other | Corporate | Eliminations | Total |
|---|----------------------------|-------------------|------------------|------------------|---------------------|--------------|
| Six Months Ended June 30, 2016 | | | | | | |
| External revenue | \$ 998,999 | \$ 182,505 | \$ 33,110 | \$ — | \$ 2,314 | \$ 1,216,928 |
| Intercompany revenue | — | 36,282 | 9,700 | — | (45,982) | — |
| Total revenue | 998,999 | 218,787 | 42,810 | — | (43,668) | 1,216,928 |
| Direct costs | 830,903 | 101,524 | 26,983 | — | (43,210) | 916,200 |
| Gross profit | 168,096 | 117,263 | 15,827 | — | (458) | 300,728 |
| Selling, general and administrative expense | 26,362 | 19,998 | 11,321 | 40,637 | — | 98,318 |
| Operating income (loss) before sale or disposal of assets | 141,734 | 97,265 | 4,506 | (40,637) | (458) | 202,410 |
| Net loss (gain) on sale or disposal of assets | 443 | (35) | 3 | (119) | — | 292 |
| Operating income (loss) | \$ 141,291 | \$ 97,300 | \$ 4,503 | \$ (40,518) | \$ (458) | \$ 202,118 |
| Depreciation and amortization | \$ 39,448 | \$ 5,620 | \$ 1,787 | \$ 1,306 | \$ (1,183) | \$ 46,978 |
| Property and equipment additions | \$ 44,030 | \$ 9,402 | \$ 2,092 | \$ 5,187 | \$ (1,897) | \$ 58,814 |
| Six Months Ended June 30, 2015 | | | | | | |
| External revenue | \$ 828,402 | \$ 168,516 | \$ 49,351 | \$ — | \$ 1,969 | \$ 1,048,238 |
| Intercompany revenue | — | 31,678 | 13,545 | — | (45,223) | — |
| Total revenue | 828,402 | 200,194 | 62,896 | — | (43,254) | 1,048,238 |
| Direct costs | 699,533 | 95,509 | 40,083 | — | (41,596) | 793,529 |
| Gross profit | 128,869 | 104,685 | 22,813 | — | (1,658) | 254,709 |
| Selling, general and administrative expense | 21,674 | 18,352 | 16,428 | 32,429 | — | 88,883 |
| Operating income (loss) before sale or disposal of assets | 107,195 | 86,333 | 6,385 | (32,429) | (1,658) | 165,826 |
| Net (gain) loss on sale or disposal of assets | (620) | 41 | 20 | 75 | — | (484) |
| Operating income (loss) | \$ 107,815 | \$ 86,292 | \$ 6,365 | \$ (32,504) | \$ (1,658) | \$ 166,310 |
| Depreciation and amortization | \$ 32,512 | \$ 5,209 | \$ 2,328 | \$ 1,167 | \$ (1,053) | \$ 40,163 |
| Property and equipment additions | \$ 26,077 | \$ 6,078 | \$ 1,300 | \$ 2,576 | \$ (1,510) | \$ 34,521 |
| At June 30, 2016 | | | | | | |
| Total assets | \$ 2,888,883 | \$ 326,719 | \$ 68,336 | \$ 1,338,562 | \$ (1,443,373) | \$ 3,179,127 |
| At December 31, 2015 | | | | | | |
| Total assets | \$ 2,186,959 | \$ 306,296 | \$ 73,491 | \$ 471,112 | \$ (536,726) | \$ 2,501,132 |

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

9. Commitments and Contingencies

We have certain commitments including operating leases, purchase agreements and acquisition agreements. These items are discussed in detail in our consolidated financial statements and notes thereto included in our 2015 Annual Report on Form 10-K. We also have contingencies as follows:

a. Earn-Out Payments

We have contractual arrangements in connection with certain acquisitions, whereby additional cash may be paid to former owners of acquired companies upon fulfillment of specified financial criteria as set forth in the respective agreements. The amount to be paid cannot be determined until the earn-out periods have expired. If the specified financial criteria are satisfied, we will be obligated to pay an additional \$ 8.5 million .

In accordance with business combination accounting guidance, contingent consideration, such as earn-outs, are recognized as part of the consideration transferred on the acquisition date. A liability is initially recorded based upon its acquisition date fair value. The changes in fair value are recognized in earnings where applicable for each reporting period. The fair value is determined using a contractually stated formula using either a multiple of revenue or Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA"). The formulas used to determine the estimated fair value are Level 3 inputs. The changes in fair value were immaterial to our condensed, consolidated financial statements taken as a whole. We recorded \$6.5 million and \$ 3.5 million in earn-out liabilities as of June 30, 2016 and December 31, 2015 , respectively, which are included in other accrued liabilities in our condensed, consolidated balance sheets.

b. Legal Proceedings

On May 29, 2013, a former veterinary assistant at one of our animal hospitals filed a purported class action lawsuit against us in the Superior Court of the State of California for the County of Los Angeles, titled Jorge Duran vs. VCA Animal Hospitals, Inc., et. al. The lawsuit seeks to assert claims on behalf of current and former veterinary assistants employed by us in California, and alleges, among other allegations, that we improperly failed to pay regular and overtime wages, improperly failed to provide proper meal and rest periods, and engaged in unfair business practices. The lawsuit seeks damages, statutory penalties, and other relief, including attorneys' fees and costs. On May 7, 2014, we obtained partial summary judgment, dismissing four of eight claims of the complaint, including the claims for failure to pay regular and overtime wages. A PAGA claim remains however it is unlikely to remain viable given the Court's ruling that meal and rest break claims are individualized. We intend to continue to vigorously defend against the remaining claim in this action. At this time, we are unable to estimate the reasonably possible loss or range of possible loss, but do not believe losses, if any, would have a material effect on our results of operations or financial position taken as a whole.

On July 16, 2014, two additional former veterinary assistants filed a purported class action lawsuit against us in the Superior Court of the State of California for the County of Los Angeles, titled La Kimba Bradsbery and Cheri Brakensiek vs. Vicar Operating, Inc., et. al. The lawsuit seeks to assert claims on behalf of current and former veterinary assistants, kennel assistants, and client service representatives employed by us in California, and alleges, among other allegations, that we improperly failed to pay regular and overtime wages, improperly failed to provide proper meal and rest periods, improperly failed to pay reporting time pay, improperly failed to reimburse for certain business-related expenses, and engaged in unfair business practices. The lawsuit seeks damages, statutory penalties, and other relief, including attorneys' fees and costs. In September 2014, the court issued an order staying the La Kimba Bradsbery lawsuit, which stay remains in place. If the stay is lifted, we intend to vigorously defend against the Bradsbery action. At this time, we are unable to estimate the reasonably possible loss or range of possible loss, but do not believe losses, if any, would have a material effect on our results of operations or financial position taken as a whole.

On July 12, 2013, an individual who provided courier services with respect to our laboratory clients in California filed a purported class action lawsuit against us in the Superior Court of the State of California for the County of Santa Clara - San Jose Branch, titled Carlos Lopez vs. Logistics Delivery Solutions, LLC, Antech Diagnostics, Inc., et. al. Logistics Delivery Solutions, LLC, a co-defendant in the lawsuit, is a company with which Antech has contracted to provide courier services in California. The lawsuit sought to assert claims on behalf of individuals who were engaged by Logistics Delivery Solutions, LLC to perform such courier services and alleges, among other allegations, that Logistics Delivery Solutions and Antech Diagnostics improperly classified the plaintiffs as independent contractors, improperly failed to pay overtime wages, and improperly failed to provide proper meal periods. The lawsuit sought damages, statutory penalties, and other relief, including

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Notes to Condensed, Consolidated Financial Statements (Continued)
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9. Commitments and Contingencies, continued

attorneys' fees and costs. The parties agreed to settle the action, on a class-wide basis, for an amount not to exceed \$1,250,000. Logistics Delivery Solutions, LLC, has agreed to pay half of the claim. Accordingly, as of June 30, 2016, we have accrued the remaining fifty percent. The settlement is not an admission of wrongdoing or acceptance of fault by any of the defendants named in the complaint. Antech Diagnostics and Logistics Delivery Solutions agreed to the settlement to eliminate the uncertainties, risk, distraction and expense associated with protracted litigation. The Court granted preliminary approval of the settlement on November 30, 2015 and issued an order granting final approval of the settlement on March 25, 2016. On April 11, 2016, the Court entered the Judgment approving the settlement and the judgment went into effect on June 1, 2016. The final settlement amount was \$903,338.92 half of which was paid by DSA pursuant to our agreement. Payments to class members were made in early July 2016 and this matter is now closed.

On May 12, 2014, an individual client who purchased goods and services from one of our animal hospitals filed a purported class action lawsuit against us in the United States District Court for the Northern District of California, titled Tony M. Graham vs. VCA Antech, Inc. and VCA Animal Hospitals, Inc. The lawsuit seeks to assert claims on behalf of the plaintiff and other individuals who purchased similar goods and services from our animal hospitals and alleges, among other allegations, that we improperly charged such individuals for "biohazard waste management" in connection with the services performed. The lawsuit seeks compensatory and punitive damages in unspecified amounts, and other relief, including attorneys' fees and costs. VCA successfully had the venue transferred to the Southern District of California. The parties have engaged in extensive discovery. Plaintiffs filed their motion for class certification on February 12, 2016. The Defendants' Opposition to the class certification is due in May 2016. As of late July 2016, VCA has filed a reply to Defendants' Opposition to class certification as well as a Summary Judgment Motion and Reply to Defendants' Opposition to the Summary Judgment Motion. A hearing on class certification and summary judgment is scheduled for mid-August. We intend to continue to vigorously defend this action. At this time, we are unable to estimate the reasonably possible loss or range of possible loss, but do not believe losses, if any, would have a material effect on our results of operations or financial position taken as a whole.

In addition to the lawsuits described above, we are party to ordinary routine legal proceedings and claims incidental to our business, but we are not currently a party to any legal proceeding that we believe would have a material adverse effect on our financial position, results of operations, or cash flows.

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

10. Noncontrolling Interests

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

a. Mandatorily Redeemable Noncontrolling Interests

The terms of some of our partnership agreements require us to purchase the partner's equity in the partnership in the event of the partner's death. We report these redeemable noncontrolling interests at their estimated redemption value, which approximates fair value, and classify them as liabilities due to the certainty of the related event. Estimated redemption value is determined using either a contractually stated formula or a discounted cash flow technique, both of which are used as an approximation of fair value. The discounted cash flow inputs used to determine the redemption value are Level 3 and include forecasted growth rates, valuation multiples, and the weighted average cost of capital. We recognize changes in the obligation as interest cost in our condensed, consolidated statements of income.

The following table provides a summary of mandatorily redeemable noncontrolling interests included in other liabilities in our condensed, consolidated balance sheets (in thousands):

| | Income Statement Impact | Mandatorily Redeemable Noncontrolling Interests |
|--|--|--|
| Balance as of December 31, 2014 | | \$ 9,405 |
| Noncontrolling interest expense | \$ 749 | |
| Redemption value change | (78) | 671 |
| Purchase of noncontrolling interests | | (803) |
| Distribution to noncontrolling interests | | (728) |
| Currency translation adjustment | | (136) |
| Balance as of June 30, 2015 | | <u>\$ 8,409</u> |
| Balance as of December 31, 2015 | | \$ 8,588 |
| Noncontrolling interest expense | \$ 827 | |
| Redemption value change | 16 | 843 |
| Distribution to noncontrolling interests | | (761) |
| Currency translation adjustment | | 168 |
| Balance as of June 30, 2016 | | <u>\$ 8,838</u> |

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

10. Noncontrolling Interests, continued

b. Redeemable Noncontrolling Interests

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

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

| | Income Statement Impact | Redeemable Noncontrolling Interests |
|--|--|--|
| Balance as of December 31, 2014 | | \$ 11,077 |
| Noncontrolling interest expense | \$ 681 | |
| Redemption value change | 196 | 877 |
| Distribution to noncontrolling interests | | (771) |
| Balance as of June 30, 2015 | | <u>\$ 11,183</u> |
| Balance as of December 31, 2015 | | \$ 11,511 |
| Noncontrolling interest expense | \$ 820 | |
| Redemption value change | 480 | 1,300 |
| Distribution to noncontrolling interests | | (758) |
| Balance as of June 30, 2016 | | <u>\$ 12,053</u> |

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

11. Recent Accounting Pronouncements

In May 2016, the FASB issued Accounting Standards Update (ASU) 2016-12, “*Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*,” to improve the guidance on Topic 606 in assessing collectibility, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition. The effective date and transition requirements of this ASU are the same as ASU 2014-09. Since the effective date of ASU 2014-09 was deferred by ASU 2015-14 by one year, ASU 2014-09 and ASU 2016-10 are effective for annual periods beginning after December 15, 2017, including interim periods within that reporting period, with early adoption permitted only as of annual periods beginning after December 15, 2016, including interim periods within that reporting period. We are currently evaluating the impact of the adoption of this ASU on our consolidated financial statements.

In May 2016, the FASB issued Accounting Standards Update (ASU) 2016-11, “*Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update)*.” This ASU rescinds the SEC paragraphs contained on Topics 605 and 815 pursuant to the SEC Staff Announcements at the March 3, 2016 EITF meeting. This ASU is effective upon the adoption of both ASU 2014-09 and 2014-16. ASU 2014-16 was effective for fiscal years beginning after December 15, 2015 and is not applicable to us. Please refer to the discussion below on ASU 2016-10 for the effective date of ASU 2014-09.

In April 2016, the FASB issued Accounting Standards Update (ASU) 2016-10, “*Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*,” to clarify some issues on Topic 606 that arose on the identifying performance obligations and the licensing implementation guidance. The effective date and transition requirements of this ASU are the same as ASU 2014-09. Since the effective date of ASU 2014-09 was deferred by ASU 2015-14 by one year, ASU 2014-09 and ASU 2016-10 are effective for annual periods beginning after December 15, 2017, including interim periods within that reporting period, with early adoption permitted only as of annual periods beginning after December 15, 2016, including interim periods within that reporting period. We are currently evaluating the impact of the adoption of this ASU on our consolidated financial statements.

In March 2016, the FASB issued Accounting Standards Update (ASU) 2016-09, “*Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*,” as part of the Board’s Simplification Initiative. The areas for simplification in this Update involves several aspects of share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for annual periods beginning after December 15, 2016, including interim periods within those annual periods, with early adoption permitted. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. We are currently evaluating the impact of the adoption of ASU 2016-09 on our consolidated financial statements.

In March 2016, the FASB issued Accounting Standards Update (ASU) 2016-08, “*Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*.” The amendments in this Update affect the guidance in Accounting Standards Update 2014-09, “*Revenue from Contracts with Customers (Topic 606)*,” which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements of Update 2014-09.

In March 2016, the FASB issued Accounting Standards Update (ASU) 2016-07, “*Investments-Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting*.” The amendments in this Update eliminate the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by step basis as if the equity method had been in effect during all previous periods that the investment had been held. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor’s previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required. The amendments in this Update require that an entity that

VCA Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
June 30, 2016
(Unaudited)

11. Recent Accounting Pronouncements, continued

has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Earlier adoption is permitted. No additional disclosures are required at transition. We do not expect this adoption to have a significant impact on our consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update (ASU) 2016-02, *“Leases (Topic 842) Section A-Leases: Amendments to the FASB Accounting Standards Codification®; Section B-Conforming Amendments Related to Leases: Amendments to the FASB Accounting Standards Codification®; Section C-Background Information and Basis for Conclusions.”* The amendments in this Update affect any entity that enters into a lease with some specified scope exemptions and supersedes Topic 840, Leases. The main difference between previous GAAP and Topic 842 is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP which did not require lease assets and lease liabilities to be recognized for most leases. The lease assets and lease liabilities arising from operating leases should be recognized in the statement of financial position. A lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. When measuring assets and liabilities arising from a lease, a lessee (and a lessor) should include payments to be made in optional periods only if the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. We are currently evaluating the impact of the adoption of ASU 2016-02 on our consolidated financial statements.

In January 2016, the FASB issued Accounting Standards Update (ASU) 2016-01, *“Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.”* An entity should present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk if the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. For public business entities, this Update is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. We do not expect this adoption to have a significant impact on our consolidated financial statements.

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

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Introduction

The following discussion should be read in conjunction with our condensed, consolidated financial statements provided under Part I, Item I of this Quarterly Report on Form 10-Q. We have included herein statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We generally identify forward-looking statements in this report using words like “believe,” “intend,” “expect,” “estimate,” “may,” “plan,” “should plan,” “project,” “contemplate,” “anticipate,” “predict,” “potential,” “continue,” or similar expressions. You may find some of these statements below and elsewhere in this report. These forward-looking statements are not historical facts and are inherently uncertain and outside of our control. Any or all of our forward-looking statements in this report may turn out to be incorrect. They can be affected by inaccurate assumptions we might make, or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this report will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially. Factors that may cause our plans, expectations, future financial condition and results to change are described throughout this report and in our Annual Report on Form 10-K, particularly in “Risk Factors,” Part I, Item 1A of that report.

The forward-looking information set forth in this Quarterly Report on Form 10-Q is as of August 5, 2016, and we undertake no duty to update this information unless required by law. Shareholders and prospective investors can find information filed with the SEC after August 5, 2016 at our website at <http://investor.vca.com> or at the SEC’s website at www.sec.gov.

We are a leading North American animal healthcare company. We provide veterinary services and diagnostic testing services to support veterinary care and we sell diagnostic imaging equipment and other medical technology products and related services to veterinarians. We also franchise a premier provider of pet services including dog day care, overnight boarding, grooming and other ancillary services at specially designed pet care facilities.

Our reportable segments are as follows:

- Our Animal Hospital segment operates the largest network of freestanding, full-service animal hospitals in the nation. Our animal hospitals offer a full range of general medical and surgical services for companion animals. We treat diseases and injuries, offer pharmaceutical and retail products and perform a variety of pet wellness programs, including health examinations, diagnostic testing, routine vaccinations, spaying, neutering and dental care. At June 30, 2016, our animal hospital network consisted of 767 animal hospitals in 43 states and in five Canadian provinces.
- Our Laboratory segment operates the largest network of veterinary diagnostic laboratories in the nation. Our laboratories provide sophisticated testing and consulting services used by veterinarians in the detection, diagnosis, evaluation, monitoring, treatment and prevention of diseases and other conditions affecting animals. At June 30, 2016, our laboratory network consisted of 60 laboratories serving all 50 states and certain areas in Canada.

For the three and six months ended June 30, 2016, our “All Other” category includes the results of our Medical Technology and Camp Bow Wow operating segments. For the comparable prior periods in 2015, our “All Other” category included the results of operations of our Vetstreet operating segment, which we sold in December 2015. Each of these segments did not meet the materiality thresholds to be considered reportable segments.

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

Use of Supplemental Non-GAAP Financial Measures

In this management's discussion and analysis, we use supplemental measures of our performance, which are derived from our consolidated financial information, but which are not presented in our consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). These financial measures, which are considered "Non-GAAP financial measures" under SEC rules, include our Non-GAAP gross profit and our Non-GAAP gross margin on a consolidated basis for our Animal Hospital segment, and the same measures expressed on a same-store basis. Additionally, our Non-GAAP financial measures include our Non-GAAP operating income and Non-GAAP operating margin on a consolidated basis. Lastly, our Non-GAAP financial measures also include our Non-GAAP consolidated net income and Non-GAAP diluted earnings per share. See *Consolidated Results of Operations - Non-GAAP Financial Measures* below for information about our use of these Non-GAAP financial measures, including our reasons for including the measures, material limitations with respect to the usefulness of the measures, and a reconciliation of each Non-GAAP financial measure to the most directly comparable GAAP financial measure.

Executive Overview

During the three and six months ended June 30, 2016, we experienced increases in consolidated revenue, gross profit and operating income. The increases were primarily driven by revenue from our acquisitions and organic growth in our Animal Hospital and Laboratory segments. Our Animal Hospital same-store revenue increased 6.3% and 7.5% for the three and six months ended June 30, 2016, respectively, as compared to the same periods in the prior year. Our Laboratory internal revenue increased 5.5% and 7.1% for the three and six months ended June 30, 2016, respectively, as compared to the same periods in the prior year. Our consolidated operating income increased 19.4% and 21.5% for the three and six months ended June 30, 2016, respectively, as compared to the same periods in the prior year. Our consolidated operating margin increased by 10 basis points and 70 basis points for the three and six months ended June 30, 2016, respectively, as compared to the same periods in the prior year. Our Non-GAAP consolidated operating income, which excludes the impact of intangible asset amortization associated with acquisitions, transaction expenses related to the acquisition of an 80% interest in Companion Animal Practices, North America ("CAPNA"), other discrete items and debt retirement costs, increased 22.3% and 24.5% for the three and six months ended June 30, 2016, respectively, as compared to the same periods in the prior year. Our Non-GAAP consolidated operating margins increased by 50 basis points and 120 basis points for the three and six months ended June 30, 2016, respectively, as compared to the same periods in the prior year. The increase in Non-GAAP consolidated operating income was primarily due to improved results from our Animal Hospital and Laboratory business segments.

Share Repurchase Program

In April 2013, our Board of Directors authorized a share repurchase for up to \$125 million of our common shares, which was completed in August 2014. In August 2014, our Board of Directors authorized the continuance of that share repurchase program, authorizing us to repurchase up to an additional \$400 million of our common shares. These repurchases may be made from time to time in open market transactions, pursuant to trading plans established in accordance with SEC rules, through privately negotiated transactions, block trades or accelerated share repurchases. The timing and number of shares repurchased will depend on a variety of factors, including price, capital availability, legal requirements and economic and market conditions. The Company is not obligated to purchase any shares under the repurchase program, and repurchases may be suspended or discontinued at any time without prior notice. During the quarter and year ended June 30, 2016, we elected to deploy our capital to fund acquisitions and accordingly, no share repurchases were made. Our share repurchase program has no expiration date. The repurchases have been and will continue to be funded by existing cash balances and by our revolving credit facility. Refer to *Item 2. Unregistered Sales of Equity Securities and the Use of Proceeds* in Part II of this report.

Recent Developments

On May 1, 2016, we acquired an 80% ownership interest in CAPNA for approximately \$351.1 million. CAPNA, founded in 2010, is located in Las Vegas, Nevada and operates a network of 56 free standing animal hospitals in 18 states.

On June 29, 2016, we entered into a new senior credit facility with various lenders for approximately \$1.7 billion of senior secured credit facilities. The New Senior Credit Facility replaced our previous senior credit facility which provided for \$600 million of term notes and a \$800 million revolving credit facility. The New Senior Credit Facility provides for \$880 million of senior secured term notes and an \$800 million senior secured revolving facility, which may be used to borrow, on a same-day notice under a swing line, the lesser of \$25 million and the aggregate unused amount of the revolving credit facility then in effect. Refer to *Note 6, Long-Term Obligations* to the Unaudited Condensed, Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Acquisitions

Our annual growth strategy includes the acquisition of independent animal hospitals. We also evaluate the acquisition of animal hospital chains, laboratories and related businesses if favorable opportunities are presented. For the six months ended June 30, 2016, we acquired \$107.8 million and \$178.3 million of annualized Animal Hospital revenue for independent animal hospitals and CAPNA, respectively.

The following table summarizes the changes in the number of facilities operated by our Animal Hospital and Laboratory segments during the six months ended June 30, 2016 and 2015, respectively:

| | Six Months Ended June 30, | |
|--------------------------|------------------------------|------------|
| | 2016 | 2015 |
| Animal Hospitals: | | |
| Beginning of period | 682 | 643 |
| Acquisitions | 37 | 23 |
| CAPNA acquisition | 56 | — |
| Acquisitions, merged | (3) | (2) |
| Sold, closed or merged | (5) | (7) |
| End of period | <u>767</u> | <u>657</u> |
| Laboratories: | | |
| Beginning of period | 60 | 59 |
| Acquisitions | — | 1 |
| Acquisitions, merged | — | (1) |
| End of period | <u>60</u> | <u>59</u> |

Critical Accounting Policies

Our condensed, consolidated financial statements have been prepared in accordance with GAAP, which require management to make estimates and assumptions that affect reported amounts. The estimates and assumptions are based on historical experience and on other factors that management believes to be reasonable. Actual results may differ from those estimates. Critical accounting policies represent the areas where more significant judgments and estimates are used in the preparation of our condensed, consolidated financial statements. A discussion of such critical accounting policies, which include revenue recognition, goodwill, other intangible assets, and income taxes, can be found in our 2015 Annual Report on Form 10-K. There have been no material changes to the policies noted above as of this Quarterly Report on Form 10-Q for the period ended June 30, 2016.

Recent Accounting Pronouncements

A discussion of recent accounting pronouncements is included in *Note 11, Recent Accounting Pronouncements* to the Unaudited Condensed, Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Consolidated Results of Operations

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|--------|------------------------------|--------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue: | | | | |
| Animal Hospital | 82.7 % | 79.3 % | 82.1 % | 79.0 % |
| Laboratory | 17.1 | 19.4 | 18.0 | 19.1 |
| All Other | 3.6 | 5.2 | 3.5 | 6.0 |
| Intercompany | (3.4) | (3.9) | (3.6) | (4.1) |
| Total revenue | 100.0 | 100.0 | 100.0 | 100.0 |
| Direct costs | 74.9 | 74.3 | 75.3 | 75.7 |
| Gross profit | 25.1 | 25.7 | 24.7 | 24.3 |
| Selling, general and administrative expense | 7.4 | 8.1 | 8.1 | 8.5 |
| Net gain on sale or disposal of assets | (0.1) | (0.1) | — | (0.1) |
| Operating income | 17.8 | 17.7 | 16.6 | 15.9 |
| Interest expense, net | 1.2 | 0.9 | 1.3 | 1.0 |
| Debt retirement costs | 0.2 | — | 0.1 | — |
| Other income | — | — | (0.1) | — |
| Income before provision for income taxes | 16.4 | 16.8 | 15.3 | 14.9 |
| Provision for income taxes | 6.2 | 6.6 | 5.9 | 5.8 |
| Net income | 10.2 | 10.2 | 9.4 | 9.1 |
| Net income attributable to noncontrolling interests | 0.4 | 0.3 | 0.3 | 0.3 |
| Net income attributable to VCA Inc. | 9.8 % | 9.9 % | 9.1 % | 8.8 % |

Revenue

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

| | Three Months Ended June 30, | | | | | Six Months Ended June 30, | | | | |
|-----------------|--------------------------------|---------------|------------|---------------|-------------|------------------------------|---------------|--------------|---------------|-------------|
| | 2016 | | 2015 | | % Change | 2016 | | 2015 | | % Change |
| | \$ | % of Total | \$ | % of Total | | \$ | % of Total | \$ | % of Total | |
| Animal Hospital | \$ 540,376 | 82.7 % | \$ 435,376 | 79.3 % | 24.1 % | \$ 998,999 | 82.1 % | \$ 828,402 | 79.0 % | 20.6 % |
| Laboratory | 112,060 | 17.1 % | 106,222 | 19.4 % | 5.5 % | 218,787 | 18.0 % | 200,194 | 19.1 % | 9.3 % |
| All Other | 23,397 | 3.6 % | 28,669 | 5.2 % | (18.4)% | 42,810 | 3.5 % | 62,896 | 6.0 % | (31.9)% |
| Intercompany | (22,344) | (3.4)% | (21,482) | (3.9)% | (4.0)% | (43,668) | (3.6)% | (43,254) | (4.1)% | (1.0)% |
| Total revenue | \$ 653,489 | 100.0 % | \$ 548,785 | 100.0 % | 19.1 % | \$ 1,216,928 | 100.0 % | \$ 1,048,238 | 100.0 % | 16.1 % |

Consolidated revenue increased \$ 104.7 million and \$ 168.7 million for the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year. The increases in revenue were primarily attributable to revenue from animal hospitals acquired since the beginning of the comparable periods in the prior year. Excluding the impact of acquisitions, revenue increased \$24.8 million and \$50.1 million for the three and six months ended June 30, 2016 , respectively, primarily due to organic growth in our Animal Hospital and Laboratory segments. The increases were partially offset by the impact of foreign currency translation. Our Animal Hospital same-store revenue increased 6.3% and 7.5% for the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year. Our Laboratory internal revenue growth was 5.5% and 7.1% for the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year.

Direct Costs

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

| | Three Months Ended June 30, | | | | | Six Months Ended June 30, | | | | |
|--------------------|--------------------------------|-----------------|------------|-----------------|-------------|------------------------------|-----------------|------------|-----------------|-------------|
| | 2016 | | 2015 | | % Change | 2016 | | 2015 | | % Change |
| | \$ | % of Revenue | \$ | % of Revenue | | \$ | % of Revenue | \$ | % of Revenue | |
| Animal Hospital | \$ 445,697 | 82.5 % | \$ 361,991 | 83.1 % | 23.1 % | \$ 830,903 | 83.2 % | \$ 699,533 | 84.4 % | 18.8 % |
| Laboratory | 51,513 | 46.0 % | 49,519 | 46.6 % | 4.0 % | 101,524 | 46.4 % | 95,509 | 47.7 % | 6.3 % |
| All Other | 14,480 | 61.9 % | 17,280 | 60.3 % | (16.2)% | 26,983 | 63.0 % | 40,083 | 63.7 % | (32.7)% |
| Intercompany | (22,149) | (3.4)% | (20,852) | (3.8)% | (6.2)% | (43,210) | (3.6)% | (41,596) | (4.0)% | (3.9)% |
| Total direct costs | \$ 489,541 | 74.9 % | \$ 407,938 | 74.3 % | 20.0 % | \$ 916,200 | 75.3 % | \$ 793,529 | 75.7 % | 15.5 % |

Consolidated direct costs increased \$81.6 million and \$ 122.7 million for the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year. The increases were primarily attributable to animal hospitals acquired since the beginning of the comparable periods in the prior year. Excluding the impact of animal hospital acquisitions and the sale of Vetstreet, the increases in direct costs were primarily due to compensation related costs, supplies, and rent, predominately in the animal hospital segment and discussed further under *Segment Results* .

Gross Profit

The following table summarizes our consolidated gross profit and consolidated Non-GAAP gross profit in dollars and as a percentage of applicable revenue (in thousands, except percentages):

| | Three Months Ended June 30, | | | | | Six Months Ended June 30, | | | | |
|---|--------------------------------|-----------------|------------|-----------------|-------------|------------------------------|-----------------|------------|-----------------|-------------|
| | 2016 | | 2015 | | % Change | 2016 | | 2015 | | % Change |
| | \$ | Gross Margin | \$ | Gross Margin | | \$ | Gross Margin | \$ | Gross Margin | |
| Animal Hospital | \$ 94,679 | 17.5% | \$ 73,385 | 16.9% | 29.0 % | \$ 168,096 | 16.8% | \$ 128,869 | 15.6% | 30.4 % |
| Laboratory | 60,547 | 54.0% | 56,703 | 53.4% | 6.8 % | 117,263 | 53.6% | 104,685 | 52.3% | 12.0 % |
| All Other | 8,917 | 38.1% | 11,389 | 39.7% | (21.7)% | 15,827 | 37.0% | 22,813 | 36.3% | (30.6)% |
| Intercompany | (195) | | (630) | | | (458) | | (1,658) | | |
| Consolidated gross profit | \$ 163,948 | 25.1% | \$ 140,847 | 25.7% | 16.4 % | \$ 300,728 | 24.7% | \$ 254,709 | 24.3% | 18.1 % |
| Intangible asset amortization associated with acquisitions | 9,187 | | 5,798 | | | 15,415 | | 11,263 | | |
| Non-GAAP consolidated gross profit and Non-GAAP gross margin ⁽¹⁾ | \$ 173,135 | 26.5% | \$ 146,645 | 26.7% | 18.1 % | \$ 316,143 | 26.0% | \$ 265,972 | 25.4% | 18.9 % |

⁽¹⁾ Non-GAAP consolidated gross profit and Non-GAAP gross margin are not measurements of financial performance prepared in accordance with GAAP. See *Non-GAAP Financial Measures* below for information about these Non-GAAP financial measures, including our reasons for including the measures, material limitations with respect to the usefulness of the measures, and a reconciliation of each Non-GAAP financial measure to the most directly comparable GAAP financial measure.

Consolidated gross profit increased \$ 23.1 million and \$ 46.0 million for the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year. Non-GAAP consolidated gross profit, which excludes the impact of intangible asset amortization associated with acquisitions, increased \$26.5 million and \$ 50.2 million for the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year. The increase in Non-GAAP consolidated gross profit was primarily attributable to acquisitions and organic revenue growth in our Animal Hospital and Laboratory business segments. The increase in Non-GAAP consolidated gross profit included \$15.4 million and \$23.3 million of gross profit related to acquisitions consummated since the beginning of the comparable periods in the prior year for the three and six months ended June 30, 2015 , respectively.

Segment Results

Animal Hospital Segment

Revenue

Animal Hospital revenue increased \$105.0 million and \$ 170.6 million for the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year. The components of the increase are summarized in the following table (in thousands, except percentages and average revenue per order):

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|--|--------------------------------|------------|----------|------------------------------|------------|----------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| Same-store facilities: | | | | | | |
| Orders ⁽¹⁾ | 2,480 | 2,446 | 1.4% | 4,733 | 4,640 | 2.0% |
| Average revenue per order ⁽²⁾ | \$ 184.21 | \$ 175.69 | 4.8% | \$ 185.08 | \$ 175.57 | 5.4% |
| Same-store revenue ⁽¹⁾ | \$ 456,841 | \$ 429,744 | 6.3% | \$ 875,976 | \$ 814,622 | 7.5% |
| Business-day adjustment ⁽³⁾ | 589 | — | | 520 | — | |
| Acquisitions | 85,403 | 4,046 | | 128,718 | 9,054 | |
| Closures | 130 | 1,586 | | 787 | 4,726 | |
| Net acquired revenue ⁽⁴⁾ | \$ 85,533 | \$ 5,632 | | \$ 129,505 | \$ 13,780 | |
| Foreign currency impact | (2,587) | — | | (7,002) | — | |
| Total | \$ 540,376 | \$ 435,376 | 24.1% | \$ 998,999 | \$ 828,402 | 20.6% |

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

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

⁽³⁾ The 2016 Business-day adjustment reflects the impact of the one additional day in 2016 as compared to 2015.

⁽⁴⁾ Net acquired revenue represents the revenue from animal hospitals acquired, net of revenue from animal hospitals sold or closed, on or after the beginning of the comparable period in the prior year. Fluctuations in net acquired revenue occur due to the volume, size, and timing of acquisitions and dispositions.

During the three and six months ended June 30, 2016 , as compared to the same periods in the prior year, our volume of same-store orders increased primarily due to the combination of positive trends in the companion animal health care industry and the impact of certain previously implemented marketing initiatives in our animal hospitals.

Our business strategy is to place a greater emphasis on comprehensive wellness visits and advanced medical procedures, which typically generate higher priced orders. During the three and six months ended June 30, 2016 , we experienced an increase in the number of higher-priced orders partially offset by a slight decrease in the number of lower-priced orders.

Price increases, as well as the mix in year over year growth rates of low to high-priced orders contributed to the overall increase in the average revenue per order. Prices at each of our animal hospitals are reviewed regularly and adjustments are made based on

market considerations, demographics and our costs. These adjustments historically approximated an increase of 3% to 6% on most services at the majority of our animal hospitals and are typically implemented in November of each year; however, price increases in November 2015 generally ranged between 4% and 6%.

Direct Costs

Animal Hospital direct costs increased \$83.7 million for the three months ended June 30, 2016, as compared to the same period in the prior year. The increase was primarily due to an increase in compensation related expenses of \$49.7 million, medical supplies of \$13.9 million, depreciation and amortization of \$4.8 million and rent of \$4.2 million. The remainder of the increase was attributed to other categories, all of which were individually immaterial. The increase in compensation related-costs and medical supplies generally are related to revenue growth and acquisitions. The increase in depreciation and amortization is related to acquired animal hospitals.

Animal Hospital direct costs increased \$131.4 million for the six months ended June 30, 2016, as compared to the same period in the prior year. The increase was primarily due to an increase in compensation related expenses of \$78.8 million, medical supplies of \$22.3 million, depreciation and amortization of \$6.4 million and rent of \$6.0 million. The remainder of the increase was attributed to other categories, all of which were individually immaterial. The increase in compensation related-costs and medical supplies generally are related to revenue growth and acquisitions. The increase in depreciation and amortization is related to acquired animal hospitals.

Gross Profit

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

The following table summarizes gross profit, gross margin, Non-GAAP gross profit and Non-GAAP gross margin for our Animal Hospital segment (in thousands, except percentages) and the same measures on a same-store basis:

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|--|--------------------------------|-----------|----------|------------------------------|------------|----------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| Gross profit | \$ 94,679 | \$ 73,385 | 29.0% | \$ 168,096 | \$ 128,869 | 30.4% |
| Intangible asset amortization associated with acquisitions | 8,195 | 4,667 | | 13,435 | 9,237 | |
| Non-GAAP gross profit ⁽¹⁾ | \$ 102,874 | \$ 78,052 | 31.8% | \$ 181,531 | \$ 138,106 | 31.4% |
| Gross margin | 17.5% | 16.9% | | 16.8% | 15.6% | |
| Non-GAAP gross margin ⁽¹⁾ | 19.0% | 17.9% | | 18.2% | 16.7% | |
| Same-store gross profit | \$ 83,570 | \$ 73,191 | 14.2% | \$ 152,663 | \$ 128,688 | 18.6% |
| Intangible asset amortization associated with acquisitions | 3,927 | 4,547 | | 7,529 | 8,922 | |
| Non-GAAP same-store gross profit ⁽¹⁾ | \$ 87,497 | \$ 77,738 | 12.6% | \$ 160,192 | \$ 137,610 | 16.4% |
| Same-store gross margin | 18.3% | 17.0% | | 17.4% | 15.8% | |
| Non-GAAP same-store gross margin ⁽¹⁾ | 19.1% | 18.1% | | 18.3% | 16.9% | |

⁽¹⁾ Non-GAAP gross profit and Non-GAAP gross margin and the same measures expressed on a same store basis, are not measurements of financial performance prepared in accordance with GAAP. See *Non-GAAP Financial Measures* below for information about these Non-GAAP financial measures, including our reasons for including the measures, material limitations with respect to the usefulness of the measures, and a reconciliation of each Non-GAAP financial measure to the most directly comparable GAAP financial measure.

Consolidated Animal Hospital gross profit increased \$ 21.3 million and \$ 39.2 million for the three and six months ended June 30, 2016, respectively, as compared to the same periods in the prior year. Non-GAAP gross profit, which excludes the impact of

intangible asset amortization associated with acquisitions, increased \$24.8 million and \$43.4 million for the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year. The increase in Non-GAAP consolidated gross profit was primarily attributable to additional gross profit from acquired animal hospitals of \$15.1 million and \$20.8 million for the three and six months ended June 30, 2016 , respectively, and same-store revenue growth.

Over the last several years, we have acquired a significant number of animal hospitals. Many of these newly acquired animal hospitals had lower gross margins at the time of acquisition than those previously operated by us. We have improved these lower gross margins, in the aggregate, subsequent to the acquisition primarily through cost efficiencies.

Laboratory Segment

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

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|--------------|--------------------------------|------------|----------|------------------------------|------------|----------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| Revenue | \$ 112,060 | \$ 106,222 | 5.5% | \$ 218,787 | \$ 200,194 | 9.3% |
| Gross profit | \$ 60,547 | \$ 56,703 | 6.8% | \$ 117,263 | \$ 104,685 | 12.0% |
| Gross margin | 54.0% | 53.4% | | 53.6% | 52.3% | |

Laboratory revenue increased \$5.8 million and \$ 18.6 million for the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year. The components of the increase in Laboratory revenue are detailed below (in thousands, except percentages and average revenue per requisition):

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|--|--------------------------------|------------|----------|------------------------------|------------|----------|
| | 2016 | 2015 | % Change | 2016 | 2015 | % Change |
| Internal growth: | | | | | | |
| Number of requisitions ⁽¹⁾ | 3,770 | 3,684 | 2.3% | 7,096 | 6,825 | 4.0% |
| Average revenue per requisition ⁽²⁾ | \$ 29.72 | \$ 28.83 | 3.1% | \$ 30.23 | \$ 29.33 | 3.1% |
| Total internal revenue ⁽¹⁾ | \$ 112,060 | \$ 106,222 | 5.5% | \$ 214,485 | \$ 200,194 | 7.1% |
| Billing-day adjustment ⁽³⁾ | — | — | | 1,402 | — | |
| Acquired revenue ⁽⁴⁾ | — | — | | 2,900 | — | |
| Total | \$ 112,060 | \$ 106,222 | 5.5% | \$ 218,787 | \$ 200,194 | 9.3% |

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

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

⁽³⁾ The 2016 Business-day adjustment reflects the impact of one additional day in 2016 as compared to 2015.

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

The increase in Laboratory revenue for the three and six months ended June 30, 2016 , as compared to the same periods in the prior year, was due to an increase in the number of requisitions and an increase in the average revenue per requisition. The change in the average revenue per requisition was impacted by price increases in February 2016 and changes in product mix.

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

Our Laboratory gross margin increased to 54.0% and 53.6% and for the three and six months ended June 30, 2016, respectively, as compared to 53.4% and 52.3% for the same periods in the prior year. The improvement in gross margins is primarily attributable to leverage on our fixed costs, including transportation costs.

Intercompany Revenue

Laboratory revenue for the three and six months ended June 30, 2016 included intercompany revenue of \$18.8 million and \$ 36.3 million, respectively, generated by providing laboratory services to our animal hospitals, as compared to \$16.5 million and \$ 31.7 million for the respective prior year periods. All Other revenue for the three and six months ended June 30, 2016 included intercompany revenue of \$4.7 million and \$ 9.7 million, respectively, generated by providing products and services to our animal hospitals and laboratories, as compared to \$5.9 million and \$ 13.5 million for the respective prior year periods. For purposes of reviewing the operating performance of our segments, all intercompany transactions are accounted for as if the transaction was with an independent third party at current market prices. For financial reporting purposes, intercompany transactions are eliminated as part of our consolidation.

Selling, General and Administrative (SG&A) Expense

SG&A is primarily comprised of costs incurred to support each of our business units. These costs typically include compensation related items for our executive, accounting, legal, information technology, marketing, training, and medical operations departments and in addition, other shared costs such as marketing and rent for corporate facilities.

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

| | Three Months Ended June 30, | | | | | Six Months Ended June 30, | | | | |
|-----------------------|--------------------------------|-----------------|------------------|-----------------|--------------|------------------------------|-----------------|------------------|-----------------|---------------|
| | 2016 | | 2015 | | % Change | 2016 | | 2015 | | % Change |
| | \$ | % of Revenue | \$ | % of Revenue | | \$ | % of Revenue | \$ | % of Revenue | |
| Animal Hospital | \$ 14,277 | 2.6% | \$ 10,453 | 2.4% | 36.6 % | \$ 26,362 | 2.6% | \$ 21,674 | 2.6% | 21.6 % |
| Laboratory | 9,702 | 8.7% | 9,487 | 8.9% | 2.3 % | 19,998 | 9.1% | 18,352 | 9.2% | 9.0 % |
| All Other | 6,022 | 25.7% | 7,741 | 27.0% | (22.2)% | 11,321 | 26.4% | 16,428 | 26.1% | (31.1)% |
| Corporate | 18,189 | 2.8% | 16,804 | 3.1% | 8.2 % | 40,637 | 3.3% | 32,429 | 3.1% | 25.3 % |
| Total SG&A | \$ 48,190 | 7.4% | \$ 44,485 | 8.1% | 8.3 % | \$ 98,318 | 8.1% | \$ 88,883 | 8.5% | 10.6 % |

Consolidated SG&A expense increased \$3.7 million for the three months ended June 30, 2016, as compared to the same period in the prior year. The increase in consolidated SG&A expense for the three months ended June 30, 2016, was primarily due to increases in compensation related expenses at our Corporate and Animal Hospital segments of \$0.7 million and \$2.1 million, respectively, related to increased headcount to support our growing operations and to a lesser extent, executive compensation. These increases were slightly offset by a decrease in our All Other SG&A expense as a result of the sale of our Vetstreet business at the end of our prior fiscal year.

Consolidated SG&A expense increased \$ 9.4 million for the six months ended June 30, 2016, as compared to the same period in the prior year. The increase in consolidated SG&A expense for the six months ended June 30, 2016, was primarily due to increases in compensation related expenses at our Corporate, Animal Hospital and Laboratory segments of \$5.3 million, \$3.6 million and \$0.7 million, respectively, related to increased headcount to support our growing operations and to a lesser extent, executive compensation. These increases were slightly offset by a decrease in our All Other SG&A expense as a result of the sale of our Vetstreet business at the end of our prior fiscal year.

Operating Income

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

| | Three Months Ended June 30, | | | | | Six Months Ended June 30, | | | | |
|--|--------------------------------|-----------------|------------|-----------------|-------------|------------------------------|-----------------|------------|-----------------|-------------|
| | 2016 | | 2015 | | % Change | 2016 | | 2015 | | % Change |
| | \$ | % of Revenue | \$ | % of Revenue | | \$ | % of Revenue | \$ | % of Revenue | |
| Animal Hospital | \$ 80,534 | 14.9% | \$ 63,846 | 14.7% | 26.1 % | \$ 141,291 | 14.1% | \$ 107,815 | 13.0% | 31.0 % |
| Laboratory | 50,880 | 45.4% | 47,181 | 44.4% | 7.8 % | 97,300 | 44.5% | 86,292 | 43.1% | 12.8 % |
| All Other | 2,892 | 12.4% | 3,637 | 12.7% | (20.5)% | 4,503 | 10.5% | 6,365 | 10.1% | (29.3)% |
| Corporate | (18,082) | | (16,853) | | (7.3)% | (40,518) | | (32,504) | | (24.7)% |
| Eliminations | (195) | | (630) | | 69.0 % | (458) | | (1,658) | | 72.4 % |
| Total GAAP consolidated operating income | \$ 116,029 | 17.8% | \$ 97,181 | 17.7% | 19.4 % | \$ 202,118 | 16.6% | \$ 166,310 | 15.9% | 21.5 % |
| Adjustments to other long-term liabilities | — | | — | | | 1,954 | | — | | |
| Transaction costs related to the CAPNA acquisition | 231 | | — | | | 1,197 | | — | | |
| Intangible asset amortization associated with acquisitions | 9,799 | | 5,858 | | | 16,027 | | 11,384 | | |
| Non-GAAP consolidated operating income and Non-GAAP consolidated operating margin ⁽¹⁾ | \$ 126,059 | 19.3% | \$ 103,039 | 18.8% | 22.3 % | \$ 221,296 | 18.2% | \$ 177,694 | 17.0% | 24.5 % |

⁽¹⁾ Non-GAAP consolidated operating income and Non-GAAP consolidated operating margin are not measurements of financial performance prepared in accordance with GAAP. See *Non-GAAP Financial Measures* below for information about these Non-GAAP financial measures, including our reasons for including the measures, material limitations with respect to the usefulness of the measures, and a reconciliation of each Non-GAAP financial measure to the most directly comparable GAAP financial measure.

Consolidated operating income increased by \$18.8 million and \$ 35.8 million during the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year. Non-GAAP consolidated operating income which excludes the impact of adjustments in the table above, increased by \$23.0 million and \$ 43.6 million for the three and six months ended June 30, 2016 , respectively, as compared to the same periods in the prior year. The increases in Non-GAAP consolidated operating income for the three and six months ended June 30, 2016 , were primarily related to improved results, as mentioned above in our Animal Hospital and Laboratory segments, offset by the decrease in our All Other operating income as a result of the sale of our Vetstreet business at the end of the prior fiscal year.

Intangible asset amortization associated with acquisitions

Included in our direct costs and SG&A is amortization expense related to our acquired intangible assets. At acquisition we assign a fair market value to identifiable intangible assets other than goodwill in our purchase price allocation. These assets include non-contractual customer relationships, covenants not-to-compete, trademarks, contracts and technology. For those identified intangible assets that have finite lives, we amortize those values over the estimated useful lives. For the three and six months ended June 30, 2016 , amortization expenses associated with acquired intangible assets were \$9.8 million and \$ 16.0 million , respectively. For the three and six months ended June 30, 2015 , amortization expenses associated with acquired intangible assets were \$5.9 million , and \$ 11.4 million , respectively.

Interest Expense, Net

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|----------|------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Interest expense: | | | | |
| Senior term notes and revolver | \$ 5,806 | \$ 3,236 | \$ 9,971 | \$ 6,304 |
| Capital leases and other | 1,762 | 1,461 | 2,999 | 2,839 |
| Amortization of debt costs | 431 | 436 | 865 | 870 |
| Non-GAAP interest expense ⁽¹⁾ | 7,999 | 5,133 | 13,835 | 10,013 |
| Adjustments to other long-term liabilities | — | — | 1,398 | — |
| Consolidated interest expense | 7,999 | 5,133 | 15,233 | 10,013 |
| Interest income | (132) | (29) | (271) | (72) |
| Total consolidated interest expense, net of interest income | \$ 7,867 | \$ 5,104 | \$ 14,962 | \$ 9,941 |

(1) Non-GAAP interest expense is not a measurement of financial performance prepared in accordance with GAAP. See *Non-GAAP Financial Measures* below for information about this financial measure including our reasons for including the measure and material limitations with respect to the usefulness of this measure.

The increase in consolidated net interest expense for the three and six months ended June 30, 2016, as compared to the same periods in the prior year, was primarily attributable to an increase in the weighted average debt balance of our senior credit facility and a higher effective LIBOR rate applied against our total credit facility. The increase in our weighted average debt balance was primarily related to additional drawings from our revolving credit facility, of which \$345 million was drawn in connection with the acquisition of CAPNA during the three months ended June 30, 2016. Drawings on the revolving credit facility during the six months ended June 30, 2016 totaled \$435 million. Additionally, an interest expense adjustment related to other long-term liabilities further contributed to increase in consolidated net interest expense for the six months ended June 30, 2016, as compared to the same period in the prior year.

Provision for Income Taxes

The effective tax rate of income attributable to VCA for the three and six months ended June 30, 2016 was 38.9% and 39.6%, as compared to 39.1% for the year ended December 31, 2015.

Inflation

Historically, our operations have not been materially affected by inflation. We cannot assure that our operations will not be affected by inflation in the future.

Non-GAAP Financial Measures

We use Non-GAAP financial measures to supplement the financial information presented on a GAAP basis. We believe that excluding certain items from our GAAP results allows our management to better understand our consolidated financial performance from period to period and in relationship to the operating results of our segments. We also believe that excluding certain items from our GAAP results allows our management to better project our future consolidated financial performance because our forecasts are developed at a level of detail different from that used to prepare GAAP-based financial measures. Moreover, we believe these Non-GAAP financial measures provide investors with useful information to help them evaluate our operating results by facilitating an enhanced understanding of our operating performance, and enabling them to make more meaningful period to period comparisons.

The Non-GAAP financial measures presented in this report include Non-GAAP gross profit and Non-GAAP gross margin, computed on a consolidated basis, for our Animal Hospital segment, and the same measures expressed on a same-store basis. Additionally, our Non-GAAP financial measures include our Non-GAAP operating income and Non-GAAP operating margin on a consolidated basis. Lastly, our Non-GAAP financial measures also include our Non-GAAP consolidated net income and Non-GAAP diluted earnings per share. These Non-GAAP financial measures, as defined by us, represent the comparable GAAP measures adjusted

to exclude certain charges or credits, as detailed in the tables above and below. In future fiscal periods, we may exclude such items and may incur income and expenses similar to these excluded items. Accordingly, the exclusion of these items and other similar items in our Non-GAAP presentation should not be interpreted as implying that these items are non-recurring, infrequent, or unusual.

There are limitations to the use of the Non-GAAP financial measures presented in this report. Our Non-GAAP financial measures may not be comparable to similarly titled measures of other companies. Other companies, including companies in our industry, may calculate the Non-GAAP financial measures differently than we do, limiting the usefulness of those measures for comparative purposes. In addition, these items can have a material impact on earnings. Our management compensates for the foregoing limitations by relying primarily on our GAAP results and using Non-GAAP financial measures supplementally. The Non-GAAP financial measures are not meant to be considered as indicators of performance in isolation from or as a substitute for consolidated gross profit or gross margin prepared in accordance with GAAP and should be read only in conjunction with financial information presented on a GAAP basis. We have presented reconciliations of each Non-GAAP financial measure to the most comparable GAAP measure for the three and six months ended June 30, 2016 and encourage you to review the reconciliations in conjunction with the presentation of the Non-GAAP financial measures for each of the periods included in this report. Refer to the tables above in the gross profit and operating income sections within Part I, Item 2 of this report for a reconciliation of consolidated gross profit to Non-GAAP gross profit and consolidated operating income to Non-GAAP operating income.

Our Non-GAAP adjustments include the following:

- **Adjustments to other long-term liabilities** - We recorded a non-cash charge to adjust certain long-term liabilities in our GAAP net income for \$3.4 million, of which \$2.0 million of related to compensation and \$1.4 million related to interest accretion.
- **Discrete tax items** - We recorded a non-cash tax adjustment to our income tax liabilities for \$1.0 million.
- **Intangible asset amortization associated with acquisitions** - Our GAAP net income includes amortization expense related to intangible assets in our acquired businesses. The amortization expense related to our acquired intangible assets can vary significantly dependent upon the amount and size of our acquisitions in each period; accordingly, we exclude amortization from our GAAP net income, for all periods presented, to provide investors with more comparable operating results.
- **Transaction costs related to the CAPNA acquisition** - For the three and six months ended June 30, 2016, we have recorded transaction costs of \$231,000 and \$1.2 million, respectively, related to our acquisition of CAPNA.
- **Debt retirement costs adjustment** - We incurred debt retirement costs of \$1.6 million in connection with our new credit facility for the three and six months ended June 30, 2016.

The following table reconciles our GAAP net income to Non-GAAP net income and calculates our Non-GAAP diluted earnings per share for the adjustments mentioned above:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|-----------|------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| GAAP net income | \$ 64,050 | \$ 54,299 | \$ 110,277 | \$ 92,600 |
| Adjustments to other long-term liabilities | — | — | 3,352 | — |
| Discrete tax items | — | — | 1,045 | — |
| Transaction costs related to CAPNA acquisition | 231 | — | 1,197 | — |
| Debt retirement costs | 1,600 | — | 1,600 | — |
| Intangible asset amortization associated with acquisitions | 9,247 | 5,858 | 15,476 | 11,384 |
| Tax benefit on above adjustments | (4,335) | (2,293) | (8,464) | (4,456) |
| Non-GAAP net income | \$ 70,793 | \$ 57,864 | \$ 124,483 | \$ 99,528 |
| Non-GAAP diluted earnings per share | \$ 0.87 | \$ 0.70 | \$ 1.53 | \$ 1.20 |
| Shares used for computing adjusted diluted earnings per share | 81,729 | 83,084 | 81,630 | 83,227 |

Liquidity and Capital Resources

Introduction

We generate cash primarily from (i) payments made by customers for our veterinary services, (ii) payments from animal hospitals and other clients for our laboratory services, and (iii) proceeds received from the sale of our imaging equipment and other related services. In addition, prior to its sale in 2015, we generated cash from payments received from participating hospitals for Vetstreet subscriptions and reminder notices. Our business historically has experienced strong liquidity, as fees for services provided in our animal hospitals are due at the time of service and fees for laboratory services are collected under standard industry terms. Our cash disbursements are primarily for payments related to the compensation of our employees, supplies and inventory purchases for our operating segments, occupancy and other administrative costs, interest expense, payments on long-term borrowings, capital expenditures, acquisitions and shares repurchases. Cash outflows fluctuate with the amount and timing of the settlement of these transactions.

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

At June 30, 2016, our consolidated cash and cash equivalents totaled \$109.7 million, representing an increase of \$10.8 million, compared to December 31, 2015. Cash flows generated from operating activities totaled at \$190.7 million for the six months ended June 30, 2016, representing an increase of \$61.0 million, compared to the six months ended June 30, 2015.

At June 30, 2016, \$ 21.0 million of the \$109.7 million of cash and cash equivalents were held by foreign subsidiaries. Our intention is to indefinitely reinvest foreign earnings in our foreign subsidiaries. If these earnings were used to fund domestic operations, they would be subject to additional income taxes upon repatriation.

We have historically funded our working capital requirements, capital expenditures, investments in the acquisition of individual hospitals and laboratories, and other smaller acquisitions primarily from internally generated cash flows. As of June 30, 2016 we had \$425 million available under our revolving credit facility, an increase of \$292 million as a result of our New Senior Credit Facility dated June 29, 2016; this allows us to maintain further operating and financial flexibility. In the future, we plan to utilize our revolving credit facility to supplement our internally generated cash flows to fund both our acquisition pipeline and our share repurchase program. See Note 6, *Long-Term Obligations*, in our condensed, consolidated financial statements of this quarterly report on Form 10-Q for a more detailed discussion.

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

Future Cash Flows

Short-Term

We anticipate that our cash on hand, net cash provided by operations and available funds under our revolving credit agreement and incremental facilities will be sufficient to meet our anticipated cash requirements for the next 12 months. If we consummate additional significant acquisitions during this period, we may seek additional debt or equity financing.

In August 2014, our Board of Directors authorized the continuance of our April 2013 share repurchase program, which was completed in August 2014. This plan authorizes us to repurchase up to an additional \$400 million of our common shares from time to time in open market purchases, pursuant to trading plans established in accordance with SEC rules, through privately negotiated transactions, block trades and accelerated share repurchases. The timing and number of shares repurchased will depend on a variety of factors, including price, capital availability, legal requirements and economic and market conditions. The Company is not obligated to purchase any shares under the repurchase program, and repurchases may be suspended or discontinued at any time without prior notice. The repurchases have been and will continue to be funded by existing cash balances and by our revolving credit facility. During the quarter ended June 30, 2016, we did not repurchase any shares under the existing repurchase authorization.

For the year ended 2016, we expect to spend approximately \$ 105.0 million for both property and equipment additions and capital costs necessary to maintain our existing facilities.

Long-Term

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

We are unable to project with certainty whether our long-term cash flow from operations will be sufficient to repay our long-term debt when it comes due. If this cash flow is insufficient, we expect that we will need to refinance such indebtedness, amend its terms to extend maturity dates, or issue common stock of our company. Our management cannot make any assurances that such refinancing or amendments, if necessary, will be available on attractive terms, if at all.

Debt Related Covenants

Our New Senior Credit Facility contains certain financial covenants pertaining to interest coverage and leverage ratios. As of June 30, 2016, we were in compliance with these covenants, including the two covenant ratios, the interest coverage ratio and the leverage ratio.

At June 30, 2016, we had an interest coverage ratio of 19.09 to 1.00, which was in compliance with the required ratio of no less than 3.00 to 1.00. The New Senior Credit Facility defines the interest coverage ratio as that ratio that is calculated on a last 12-month basis by dividing pro forma earnings before interest, taxes, depreciation and amortization, as defined by our New Senior Credit Facility (“pro forma earnings”), by consolidated interest expense. Interest expense is defined as total interest expense with respect to all outstanding indebtedness, including commissions, discounts and other fees charged related to letters of credit. Pro forma earnings include 12 months of operating results for businesses acquired during the period.

At June 30, 2016, we had a leverage ratio of 2.68 to 1.00, which was in compliance with the required ratio of no more than 4.00 to 1.00 from June 30, 2016 until December 31, 2016 as defined under the New Senior Credit facility. The New Senior Credit Facility defines the leverage ratio as that ratio which is calculated as total debt divided by pro forma earnings.

Historical Cash Flows

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

| | Six Months Ended June 30, | |
|---|------------------------------|------------|
| | 2016 | 2015 |
| Cash provided by (used in): | | |
| Operating activities | \$ 190,713 | \$ 129,756 |
| Investing activities | (604,334) | (94,681) |
| Financing activities | 424,104 | (42,210) |
| Effect of currency exchange rate changes on cash and cash equivalents | 313 | 78 |
| Increase (decrease) in cash and cash equivalents | 10,796 | (7,057) |
| Cash and cash equivalents at beginning of period | 98,888 | 81,383 |
| Cash and cash equivalents at end of period | \$ 109,684 | \$ 74,326 |

Cash Flows from Operating Activities

Net cash provided by operating activities increased by \$ 61.0 million for the six months ended June 30, 2016, as compared to the prior-year period. Operating cash flows for the six months ended June 30, 2016 included \$114.1 million of net income, net non-cash expenses of \$67.0 million and net cash provided as a result of changes in operating assets and liabilities of \$ 9.6 million. The changes in operating assets and liabilities included a \$23.6 million decrease in prepaid income taxes, a \$5.9 million increase in accounts payable and other accrued liabilities and accrued interest, and a \$2.8 million increase in accrued payroll and related liabilities, partially offset by a \$15.6 million increase in inventory, prepaid expenses and other assets, and a \$7.1 million increase in trade accounts receivable. The decrease in prepaid income taxes was due to the timing of payment obligations and the increases in accounts payable and other accrued liabilities and accrued interest, and accrued payroll and related liabilities were primarily due to the acquisition of CAPNA as well as the timing of payment obligations. The increase in inventory, prepaid expenses and other assets was primarily due to the acquisition of CAPNA and invoice processing on behalf of Vetstreet Inc. The increase in trade accounts receivable was primarily due to increased revenues in both our Hospital and Laboratory business segments as compared to the prior-year period.

Net cash provided by operating activities increased by \$1.6 million for the six months ended June 30, 2015, as compared to the prior-year period. Operating cash flows for the six months ended June 30, 2015 included \$95.5 million of net income, net non-cash expenses of \$46.8 million and net cash used as a result of changes in operating assets and liabilities of \$12.5 million. The changes in operating assets and liabilities included a \$24.2 million increase in trade accounts receivable, an \$8.9 million increase in inventory, prepaid expenses and other assets, and a \$4.2 million decrease in accounts payable and accrued liabilities, partially offset by a \$16.5 million decrease in prepaid income taxes and an \$8.3 million increase in accrued payroll and related liabilities. The increase in trade accounts receivable was primarily due to an increase in our Laboratory segment revenue as compared to the prior-year period, as well as increased revenue related to our Hospital segment. The increase in inventory, prepaid expenses, and other assets was primarily due to increases in service agreements entered into by our Laboratory segment, as well as deferred transaction costs related to acquisitions from our Hospital segment. These increases are partially offset by the receipt of the insurance payments related to the May 2014 fire at our Medical Technology business and the depletion of certain products. The decreases in accounts payable and accrued liabilities and prepaid income taxes, and the increase in accrued payroll and related liabilities was primarily due to the timing of payment obligations.

Cash Flows from Investing Activities

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

| | Six Months Ended June 30, | | Change |
|---|--------------------------------------|--------------------|-----------------------------|
| | 2016 | 2015 | |
| Investing Cash Flows: | | | |
| Business acquisitions, net of cash acquired | \$ (540,878) | \$ (66,529) | \$ (474,349) ⁽¹⁾ |
| Property and equipment additions | (58,814) | (34,521) | (24,293) ⁽²⁾ |
| Proceeds from sale or disposal of assets | 282 | 6,164 | (5,882) ⁽³⁾ |
| Other | (4,924) | 205 | (5,129) ⁽⁴⁾ |
| Net cash used in investing activities | <u>\$ (604,334)</u> | <u>\$ (94,681)</u> | <u>\$ (509,653)</u> |

⁽¹⁾ The number of acquisitions will vary from period to period based upon the available pool of suitable candidates, however, the increase is primarily attributable to the acquisition of CAPNA during the six months ended June 30, 2016. A discussion of our acquisitions is provided above in our *Executive Overview*.

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

⁽³⁾ The proceeds from the sale or disposal of assets in 2015 primarily relates to the sale of a hospital.

⁽⁴⁾ We paid \$4.6 million in connection with our acquisition holdbacks. Payouts will vary from period to period based on the timing of each acquisition and the acquisition holdback period.

Cash Flows from Financing Activities

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

| | Six Months Ended June 30, | | Change |
|--|------------------------------|--------------------|-------------------------------|
| | 2016 | 2015 | |
| Financing Cash Flows: | | | |
| Repayment of long-term obligations | \$ (1,256,250) | \$ (7,924) | \$ (1,248,326) ⁽¹⁾ |
| Proceeds from issuance of long-term obligations | 1,255,000 | — | 1,255,000 ⁽¹⁾ |
| Proceeds from revolving credit facility | 435,000 | 61,000 | 374,000 ⁽²⁾ |
| Payment of financing costs | (3,829) | — | (3,829) ⁽¹⁾ |
| Distribution to noncontrolling interests | (2,554) | (2,447) | (107) |
| Purchase of noncontrolling interests | (3,730) | (1,493) | (2,237) ⁽³⁾ |
| Proceeds from issuance of common stock under stock incentive plans | 1,122 | 679 | 443 |
| Excess tax benefits from share-based compensation | 1,421 | 4,729 | (3,308) ⁽⁴⁾ |
| Stock repurchases | (843) | (96,674) | 95,831 ⁽⁵⁾ |
| Other | (1,233) | (80) | (1,153) |
| Net cash provided by (used in) financing activities | <u>\$ 424,104</u> | <u>\$ (42,210)</u> | <u>\$ 466,314</u> |

⁽¹⁾ On June 29, 2016 we entered into a New Senior Credit Facility which resulted in the payoff of our previous senior credit facility in the amount of \$577.5 million and \$667.0 million for our term notes and revolving credit facility, respectively, proceeds of \$880.0 million and \$375.0 million from the issuance of new senior secured term notes and borrowings under our senior secured revolving facility, respectively, and payments of \$3.8 million related to financing costs to creditors and third parties. A discussion of our New Senior Credit Facility is provided above in *Note 6, Long-Term Obligations*. Additionally, the repayments of long-term obligations also include \$9.1 million in scheduled senior-term note principal and capital lease payments. Our principal payment obligations on our New Senior Credit Facility do not commence until September 2016.

⁽²⁾ We borrowed \$435.0 million from our previous revolving credit facility in which the proceeds were primarily used to fund our acquisitions.

The \$61.0 million borrowed from our previous revolving credit facility in 2015 was primarily used to fund stock repurchases under our existing \$400.0 million share repurchase authorization and fund our acquisitions.

⁽³⁾ The cash paid to purchase noncontrolling interests will vary based upon differing opportunities and circumstances during each of the respective periods.

⁽⁴⁾ The amount of excess tax benefits varies from period to period based upon the volume of options exercised or number of shares vested, and the related stock price at the time these stock activities occur.

⁽⁵⁾ For the six months ended June 30, 2016, the cash paid for stock repurchases related to income taxes paid on behalf of employees who elected to settle their tax obligation on vested stock with a portion of their vested stock.

For the six months ended June 30, 2015, the cash paid for stock repurchases included both the repurchase of our common shares in accordance with our share repurchase program and income taxes paid on behalf of employees who elected to settle their tax obligation on vested stock with a portion of their vested stock.

Future Contractual Cash Requirements

The following table sets forth material changes from the amounts reported in our 2015 Form 10-K to our scheduled principal and interest due by us for each of the years indicated as of June 30, 2016 (in thousands):

| | Payment due by period | | | | |
|--|-----------------------|---------------------|-------------------|---------------------|----------------------|
| | Total | Less than 1 Year | 1-3 years | 3-5 years | More than 5 years |
| Contractual Obligations: | | | | | |
| Long-term debt | \$ 1,255,230 | \$ 22,230 | \$ 88,000 | \$ 1,145,000 | \$ — |
| Variable cash interest expense Term A ⁽¹⁾ | 128,212 | 27,592 | 52,800 | 47,820 | — |
| | <u>\$ 1,383,442</u> | <u>\$ 49,822</u> | <u>\$ 140,800</u> | <u>\$ 1,192,820</u> | <u>\$ —</u> |

⁽¹⁾ The interest payments on our variable-rate senior term notes are based on rates effective as of June 30, 2016 .

Off-Balance-Sheet Financing Arrangements

Other than operating leases, as of June 30, 2016 , we do not have any off-balance-sheet financing arrangements.

Description of Indebtedness

New Senior Credit Facility

We entered into a new senior credit facility on June 29, 2016 and pay interest on our senior term notes and revolving credit facility based on the interest rate offered to our administrative agent on, the Eurodollar rate plus the applicable margin determined by reference to the leverage ratio in effect from time-to-time, ranging from 1.00% to 2.00% per annum, as set forth in the table in Note 6, *Long-Term Obligations* , of this quarterly report on Form 10-Q. We pay a commitment fee on our revolving credit facility determined by reference to the Leverage Ratio in effect from time-to-time ranging from 0.25% to 0.40% per annum, as set forth in Note 6, *Long-Term Obligations*, of this quarterly report on Form 10-Q.

At June 30, 2016 , we had \$880 million in principal outstanding under our senior term notes and \$375 million borrowings outstanding under our revolving credit facility.

The senior term notes and the revolving credit facility mature in June 2021.

Other Debt and Capital Lease Obligations

At June 30, 2016 , we had a seller note secured by assets of a certain animal hospital, capital leases, and other debt that consisted of \$4.0 million and \$53.9 million included in the current portion and non-current portion of long-term debt, respectively. Our seller note matures in 2016 and has an interest rate of 10.0% . Our capital leases and other debt have various maturities through 2042 and various interest rates ranging from 1.9% to 15.0% .

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in our quantitative and qualitative disclosures about market risk from those disclosed in Part II, Item 7A, of our 2015 Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

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

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

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On May 29, 2013, a former veterinary assistant at one of our animal hospitals filed a purported class action lawsuit against us in the Superior Court of the State of California for the County of Los Angeles, titled Jorge Duran vs. VCA Animal Hospitals, Inc., et. al. The lawsuit seeks to assert claims on behalf of current and former veterinary assistants employed by us in California, and alleges, among other allegations, that we improperly failed to pay regular and overtime wages, improperly failed to provide proper meal and rest periods, and engaged in unfair business practices. The lawsuit seeks damages, statutory penalties, and other relief, including attorneys' fees and costs. On May 7, 2014, we obtained partial summary judgment, dismissing four of eight claims of the complaint, including the claims for failure to pay regular and overtime wages. A PAGA claim remains however it is unlikely to remain viable given the Court's ruling that meal and rest break claims are individualized. We intend to continue to vigorously defend against the remaining claim in this action. At this time, we are unable to estimate the reasonably possible loss or range of possible loss, but do not believe losses, if any, would have a material effect on our results of operations or financial position taken as a whole.

On July 16, 2014, two additional former veterinary assistants filed a purported class action lawsuit against us in the Superior Court of the State of California for the County of Los Angeles, titled La Kimba Bradsbery and Cheri Brakensiek vs. Vicar Operating, Inc., et. al. The lawsuit seeks to assert claims on behalf of current and former veterinary assistants, kennel assistants, and client service representatives employed by us in California, and alleges, among other allegations, that we improperly failed to pay regular and overtime wages, improperly failed to provide proper meal and rest periods, improperly failed to pay reporting time pay, improperly failed to reimburse for certain business-related expenses, and engaged in unfair business practices. The lawsuit seeks damages, statutory penalties, and other relief, including attorneys' fees and costs. In September 2014, the court issued an order staying the La Kimba Bradsbery lawsuit, which stay remains in place. If the stay is lifted, we intend to vigorously defend against the Bradsbery action. At this time, we are unable to estimate the reasonably possible loss or range of possible loss, but do not believe losses, if any, would have a material effect on our results of operations or financial position taken as a whole.

On July 12, 2013, an individual who provided courier services with respect to our laboratory clients in California filed a purported class action lawsuit against us in the Superior Court of the State of California for the County of Santa Clara - San Jose Branch, titled Carlos Lopez vs. Logistics Delivery Solutions, LLC, Antech Diagnostics, Inc., et. al. Logistics Delivery Solutions, LLC, a co-defendant in the lawsuit, is a company with which Antech has contracted to provide courier services in California. The lawsuit sought to assert claims on behalf of individuals who were engaged by Logistics Delivery Solutions, LLC to perform such courier services and alleges, among other allegations, that Logistics Delivery Solutions and Antech Diagnostics improperly classified the plaintiffs as independent contractors, improperly failed to pay overtime wages, and improperly failed to provide proper meal periods. The lawsuit sought damages, statutory penalties, and other relief, including attorneys' fees and costs. The parties agreed to settle the action, on a class-wide basis, for an amount not to exceed \$1,250,000. Logistics Delivery Solutions, LLC, has agreed to pay half of the claim. Accordingly, as of June 30, 2016, we have accrued the remaining fifty percent. The settlement is not an admission of wrongdoing or acceptance of fault by any of the defendants named in the complaint. Antech Diagnostics and Logistics Delivery Solutions agreed to the settlement to eliminate the uncertainties, risk, distraction and expense associated with protracted litigation. The Court granted preliminary approval of the settlement on November 30, 2015 and issued an order granting final approval of the settlement on March 25, 2016. On April 11, 2016, the Court entered the Judgment approving the settlement and the judgment went into effect on June 1, 2016. The final settlement amount was \$903,338.92, half of which was paid by DSA pursuant to our agreement. Payments to class members were made in early July 2016 and this matter is now closed.

On May 12, 2014, an individual client who purchased goods and services from one of our animal hospitals filed a purported class action lawsuit against us in the United States District Court for the Northern District of California, titled Tony M. Graham vs. VCA Antech, Inc. and VCA Animal Hospitals, Inc. The lawsuit seeks to assert claims on behalf of the plaintiff and other individuals who purchased similar goods and services from our animal hospitals and alleges, among other allegations, that we improperly charged such individuals for "biohazard waste management" in connection with the services performed. The lawsuit seeks compensatory and punitive damages in unspecified amounts, and other relief, including attorneys' fees and costs. VCA successfully had the venue transferred to the Southern District of California. The parties have engaged in extensive discovery. Plaintiffs filed their motion for class certification on February 12, 2016. The Defendants' Opposition to the class certification is due in May 2016. As of late July 2016, VCA has filed a reply to Defendants' Opposition to class certification as well as a Summary Judgment Motion and Reply to Defendants' Opposition to the Summary Judgment Motion. A hearing on

class certification and summary judgment is scheduled for mid-August. We intend to continue to vigorously defend this action. At this time, we are unable to estimate the reasonably possible loss or range of possible loss, but do not believe losses, if any, would have a material effect on our results of operations or financial position taken as a whole.

In addition to the lawsuits described above, we are party to ordinary routine legal proceedings and claims incidental to our business, but we are not currently a party to any legal proceeding that we believe would have a material adverse effect on our financial position, results of operations, or cash flows.

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those disclosed in Part I, Item 1A, of our 2015 Annual Report on Form 10-K.

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

Transactions in Our Equity Securities

For the period covered by this report, we have not engaged in any transactions involving the sale of our unregistered equity securities that were not disclosed in a Quarterly Report on Form 10-Q or a current report on Form 8-K. We have not engaged in any sales of registered securities for which the use of proceeds is required to be disclosed.

The following table provides information on shares of our common stock we repurchased during the quarter ended June 30, 2016 :

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan or Program | Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plan or Program |
|---------------------------------|--|------------------------------------|--|--|
| (1) | (2) | (3) | (4) | (4) |
| April 1, 2016 to April 30, 2016 | — | \$ — | — | \$ 101,058,831 |
| May 1, 2016 to May 31, 2016 | — | \$ — | — | \$ 101,058,831 |
| June 1, 2016 to June 30, 2016 | — | \$ — | — | \$ 101,058,831 |
| | — | \$ — | — | \$ 101,058,831 |

(1) Information is based on settlement dates of repurchase transactions.

(2) Consists of shares of our common stock, par value \$0.001 per share. For the quarter ended June 30, 2016, no shares were repurchased in the open market or in block trades pursuant to a previously-announced share repurchase program (see (4) below). There were also no shares of common stock surrendered to us by employees to satisfy minimum statutory tax withholding obligations in connection with the vesting of restricted stock and payout of restricted stock units.

(3) The average price paid for shares repurchased under the Share Repurchase Program excludes commissions paid.

(4) In April 2013, our Board of Directors authorized a repurchase program to purchase up to \$125 million in shares of our common stock. As of August 2014, we have completed this program and our Board of Directors authorized a new repurchase program to buyback up to \$400 million in shares of our common stock in open market purchases or negotiated transactions.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

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

- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase
- 101.DEF XBRL Taxonomy Definition Linkbase
- 101.LAB XBRL Taxonomy Extension Label Linkbase
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on August 5, 2016 .

Date: August 5, 2016

By: /s/ Tomas W. Fuller

Tomas W. Fuller

Chief Financial Officer, Principal Accounting Officer,
and Vice President and Secretary

EXHIBIT INDEX

| <u>Exhibit No.</u> | <u>Description</u> |
|---------------------------|---|
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
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| Exhibit 101.LAB | XBRL Extension Label Linkbase Document |
| Exhibit 101.PRE | XBRL Extension Presentation Linkbase Document |
| Exhibit 101.DEF | XBRL Extension Definition Linkbase Document |

EXHIBIT 31.1

**Certification of
Chief Executive Officer
of VCA Inc.**

I, Robert L. Antin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of VCA Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the Audit Committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 5, 2016

/s/ Robert L. Antin

Robert L. Antin

Chairman of the Board, President and Chief
Executive Officer

EXHIBIT 31.2

**Certification of
Chief Financial Officer
of VCA Inc.**

I, Tomas W. Fuller, certify that:

1. I have reviewed this quarterly report on Form 10-Q of VCA Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the Audit Committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 5, 2016

/s/ Tomas W. Fuller

Tomas W. Fuller

Chief Financial Officer, Principal Accounting
Officer, and Vice President and Secretary

EXHIBIT 32.1

**Certification of
Chief Executive Officer & Chief Financial Officer
of VCA Inc.**

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and accompanies this quarterly report on Form 10-Q (the "Report") for the period ended June 30, 2016 of VCA Inc. (the "Issuer").

Each of the undersigned, who are the Chief Executive Officer and Chief Financial Officer, respectively, of VCA Inc., hereby certify that, to the best of each such officer's knowledge:

- (i) the Report fully complies with the requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Issuer.

Date: August 5, 2016

/s/ Robert L. Antin

Robert L. Antin

Chairman of the Board, President and Chief
Executive Officer

/s/ Tomas W. Fuller

Tomas W. Fuller

Chief Financial Officer, Principal Accounting
Officer, and Vice President and Secretary