VCA ANTECH INC
Form 10-Q
November 08, 2013

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

FORM 10-Q

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

For the quarterly period ended September 30, 2013

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

Commission File Number: 001-16783

VCA Antech, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	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 [ ] (Do not check if a smaller reporting company)	Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [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, 88,749,756 shares as of November 4, 2013.

VCA Antech, Inc. and Subsidiaries
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$153,174	$68,435
Trade accounts receivable, less allowance for uncollectible accounts of $17,420 and $16,546 at September 30, 2013 and December 31, 2012, respectively	60,770	55,912
Inventory	51,929	51,456
Prepaid expenses and other	25,115	25,086
Deferred income taxes	26,130	22,579
Prepaid income taxes	1,512	20,061
Total current assets	318,630	243,529
Property and equipment, net	445,392	403,444
Goodwill	1,320,952	1,291,231
Other intangible assets, net	90,139	94,823
Notes receivable, net	3,474	6,080
Deferred financing costs, net	3,295	4,232
Other	53,453	48,241
Total assets	$2,235,335	$2,091,580
Liabilities and Equity		
Current liabilities:		
Current portion of long-term debt	$51,232	$39,002
Accounts payable	37,797	39,416
Accrued payroll and related liabilities	62,323	49,893
Other accrued liabilities	63,814	57,131
Total current liabilities	215,166	185,442
Long-term debt, less current portion	581,145	591,641
Deferred income taxes	82,568	75,846
Other liabilities	35,947	37,267
Total liabilities	914,826	890,196
Commitments and contingencies		
Redeemable noncontrolling interests	11,031	6,991
Preferred stock, par value $0.001, 11,000 shares authorized, none outstanding	—	—
VCA Antech, Inc. stockholders’ equity:		
Common stock, par value $0.001, 175,000 shares authorized, 88,948 and 88,372 shares outstanding as of September 30, 2013 and December 31, 2012, respectively	89	88
Additional paid-in capital	398,099	390,359
Retained earnings	904,003	791,209
Accumulated other comprehensive (loss) income	(1,861)	1,847
Total VCA Antech, Inc. stockholders’ equity	1,300,330	1,183,503
Noncontrolling interests	9,148	10,890
Total equity	1,309,478	1,194,393

Total liabilities and equity	$2,235,335	$2,091,580

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenue	$464,055	$433,613	$1,367,916	$1,281,450
Direct costs	353,378	334,432	1,046,022	988,283
Gross profit	110,677	99,181	321,894	293,167
Selling, general and administrative expense	38,747	37,608	117,616	115,656
Net (gain) loss on sale or disposal of assets	(109)	387	1,187	1,022
Operating income	72,039	61,186	203,091	176,489
Interest expense, net	4,474	4,295	14,439	12,746
Business combination adjustment gain	—	—	—	(5,719)
Other income	(86)	(284)	(113)	(639)
Income before provision for income taxes	67,651	57,175	188,765	170,101
Provision for income taxes	25,740	21,533	71,571	62,360
Net income	41,911	35,642	117,194	107,741
Net income attributable to noncontrolling interests	1,264	1,605	4,400	4,139
Net income attributable to VCA Antech, Inc	$40,647	$34,037	$112,794	$103,602
Basic earnings per share	$0.46	$0.39	$1.27	$1.18
Diluted earnings per share	$0.45	$0.38	$1.26	$1.17
Weighted-average shares outstanding for basic earnings per share	88,834	87,773	88,583	87,554
Weighted-average shares outstanding for diluted earnings per share	89,845	88,654	89,659	88,589

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income[1]	$41,911	$35,642	$117,194	$107,741
Other comprehensive income:				
Foreign currency translation adjustments	2,633	2,878	(3,708)	2,465
Other comprehensive loss	2,633	2,878	(3,708)	2,465
Total comprehensive income	44,544	38,520	113,486	110,206
Comprehensive income attributable to noncontrolling interests[1]	1,264	1,605	4,400	4,139
Comprehensive income attributable to VCA Antech, Inc.	$43,280	$36,915	$109,086	$106,067

(1) Includes approximately $2.6 million and $2.1 million of net income related to redeemable and mandatorily redeemable noncontrolling interests for the nine months ended September 30, 2013 and 2012, respectively.

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

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total
Balances, December 31, 2011	86,796	$ 87	$ 361,715	$ 745,658	$ 418	$ 10,074	$ 1,117,952
Net income (excludes $702 and $1,359 related to redeemable and mandatorily redeemable noncontrolling interests, respectively).	—	—	—	103,602	—	2,078	105,680
Other comprehensive income	—	—	—	—	2,465	—	2,465
Distribution to noncontrolling interests	—	—	—	—	—	(1,102)	(1,102)
Share-based compensation	—	—	10,466	—	—	—	10,466
Issuance of common stock under stock incentive plans	745	1	3,321	—	—	—	3,322
Issuance of common stock for acquisitions	473	—	10,500	—	—	—	10,500
Stock repurchases	(185)	—	(3,933)	—	—	—	(3,933)
Excess tax benefit from stock options	—	—	358	—	—	—	358
Tax shortfall and other from stock options and awards	—	—	52	—	—	—	52
Balances, September 30, 2012	87,829	$ 88	$ 382,479	$ 849,260	$ 2,883	$ 11,050	$ 1,245,760
Balances, December 31, 2012	88,372	$ 88	$ 390,359	$ 791,209	$ 1,847	$ 10,890	$ 1,194,393
Net income (excludes $1,152 and $1,475 related to redeemable and mandatorily redeemable noncontrolling interests, respectively).	—	—	—	112,794	—	1,773	114,567
Other comprehensive loss	—	—	—	—	(3,708)	—	(3,708)
Formation of noncontrolling interests	—	—	—	—	—	1,806	1,806
Distribution to noncontrolling interests	—	—	—	—	—	(1,175)	(1,175)
Purchase of noncontrolling interests	—	—	(976)	—	—	(4,309)	(5,285)
Share-based compensation	—	—	10,340	—	—	—	10,340
Issuance of common stock under stock incentive plans	1,313	1	15,110	—	—	—	15,111
Stock repurchases	(737)	—	(19,384)	—	—	—	(19,384)
Excess tax benefit from stock options	—	—	2,654	—	—	—	2,654

Tax benefit and other from stock options and awards	—	—	(4)	—	—	—	(4)
Other	—	—	—	—	—	163	163
Balances, September 30, 2013	88,948	$ 89	$ 398,099	$ 904,003	$ (1,861)	$ 9,148	$ 1,309,478

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

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

	Nine Months Ended September 30,	
	2013	2012
Cash flows from operating activities:		
Net income	$117,194	$107,741
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	57,783	56,882
Amortization of debt issue costs	937	961
Provision for uncollectible accounts	5,380	4,437
Business combination adjustment gain	—	(5,719)
Net loss on disposal of assets	1,187	1,022
Share-based compensation	10,340	10,466
Deferred income taxes	2,868	14,119
Excess tax benefit from exercise of stock options	(2,654)	(358)
Other	(251)	(838)
Changes in operating assets and liabilities:		
Trade accounts receivable	(9,986)	(5,079)
Inventory, prepaid expense and other assets	(1,634)	(6,727)
Accounts payable and other accrued liabilities	4,941	3,161
Accrued payroll and related liabilities	11,408	10,007
Income taxes	21,492	(1,636)
Net cash provided by operating activities	219,005	188,439
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(39,640)	(108,031)
Real estate acquired in connection with business acquisitions	(1,208)	(1,602)
Property and equipment additions	(52,682)	(55,257)
Proceeds from sale of assets	905	112
Other	(1,738)	(1,583)
Net cash used in investing activities	(94,363)	(166,361)
Cash flows from financing activities:		
Repayment of debt	(28,507)	(52,040)
Proceeds from issuance of long-term debt	—	50,000
Proceeds from revolving credit facility	—	50,000
Repayment of revolving credit facility	—	(50,000)
Payment of financing costs	—	(122)
Distributions to noncontrolling interest partners	(3,324)	(2,802)
Purchase of noncontrolling interests	(5,727)	—
Proceeds from issuance of common stock under stock option plans	15,111	3,322
Excess tax benefit from exercise of stock options	2,654	358
Repurchase of common stock	(19,384)	(3,897)
Other	(160)	(1,273)
Net cash used in financing activities	(39,337)	(6,454)
Effect of currency exchange rate changes on cash and cash equivalents	(566)	386
Increase in cash and cash equivalents	84,739	16,010
Cash and cash equivalents at beginning of period	68,435	63,651

Cash and cash equivalents at end of period	$153,174	$79,661

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

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

	Nine Months Ended September 30, 2013	2012
Supplemental disclosures of cash flow information:		
Interest paid	$9,487	$11,614
Income taxes paid	$47,305	$48,671
Supplemental schedule of noncash investing and financing activities:		
Detail of acquisitions:		
Fair value of assets acquired	$58,825	$187,515
Fair value of pre-existing investment in AVC	—	(11,850)
Noncontrolling interest	(5,406)	(8,161)
Cash paid for acquisitions	(39,640)	(108,031)
Cash paid to debt holders	(2,360)	(25,915)
Issuance of common stock for acquisitions	—	(10,500)
Contingent consideration	(1,120)	(934)
Holdbacks	(892)	(2,525)
Liabilities assumed	$9,407	$19,599
Other noncash items:		
Capital lease additions	$21,668	$—

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

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements
September 30, 2013
(Unaudited)

1. Nature of Operations

Our company, VCA Antech, Inc. (“VCA”) is a Delaware corporation formed in 1986 and is based in Los Angeles, California. We are an animal healthcare company with the following four operating segments: animal hospitals ("Animal Hospital"), veterinary diagnostic laboratories (“Laboratory”), veterinary medical technology (“Medical Technology”), and Vetstreet. Our operating segments are aggregated into two reportable segments "Animal Hospital" and "Laboratory". Our Medical Technology and Vetstreet operating segments are combined in our "All Other" category. See Footnote 9, "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 September 30, 2013, we operated 606 animal hospitals throughout 41 states and four 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 September 30, 2013, we operated 56 laboratories of various sizes located strategically throughout the United States and Canada.

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

Our Vetstreet business provides several different services to the veterinary community including, online communications, professional education, marketing solutions and a home delivery platform for independent animal hospitals.

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 three and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the full year ending December 31, 2013. For further information, refer to our consolidated financial statements and notes thereto included in our 2012 Annual Report on Form 10-K.

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

During the quarter ended September 30, 2013, we recorded a non-cash physical inventory adjustment in our Animal Hospital business segment, which resulted in a $2.8 million credit adjustment to direct costs.

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
September 30, 2013
(Unaudited)

3. Goodwill and Other Intangible Assets

Goodwill

The following table presents the changes in the carrying amount of our goodwill for the nine months ended September 30, 2013 (in thousands):

	Animal Hospital	Laboratory	All Other	Total
Balance as of December 31, 2012				
Goodwill	$1,177,348	$96,861	$137,833	$1,412,042
Accumulated impairment losses	—	—	(120,811)	(120,811)
Balance as of December 31, 2012, net	1,177,348	96,861	17,022	1,291,231
Goodwill acquired	32,549	8	—	32,557
Foreign translation adjustment	(2,836)	(22)	—	(2,858)
Other [(1)]	(421)	—	443	22
Balance as of September 30, 2013				
Goodwill	1,206,640	96,847	138,276	1,441,763
Accumulated impairment losses	—	—	(120,811)	(120,811)
Balance as of September 30, 2013, net	$1,206,640	$96,847	$17,465	$1,320,952

[(1)] Other primarily includes measurement period adjustments and a write-off related to a sale of an animal hospital.

Other Intangible Assets

Our acquisition related amortizable intangible assets at September 30, 2013 and December 31, 2012 are as follows (in thousands):

	As of September 30, 2013			As of December 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Non-contractual customer relationships	$113,573	$(41,637)	$71,936	$110,404	$(36,605)	$73,799
Covenants not-to-compete	9,873	(5,458)	4,415	12,707	(7,357)	5,350
Favorable lease assets	7,465	(4,252)	3,213	7,228	(3,866)	3,362
Trademarks	12,096	(3,865)	8,231	12,494	(3,001)	9,493
Contracts	956	(633)	323	956	(570)	386
Technology	4,901	(2,891)	2,010	6,588	(4,179)	2,409
Client lists	50	(39)	11	50	(26)	24
Total	$148,914	$(58,775)	$90,139	$150,427	$(55,604)	$94,823

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
September 30, 2013
(Unaudited)

3. Goodwill and Other Intangible Assets, continued

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Aggregate amortization expense	$5,588	$6,612	$16,153	$16,830

The estimated amortization expense related to acquisition related intangible assets for the remainder of 2013 and each of the succeeding years thereafter, as of September 30, 2013, is as follows (in thousands):

Remainder of 2013	$5,471
2014	20,613
2015	18,557
2016	15,520
2017	9,096
Thereafter	20,882
Total	$90,139

4. Acquisitions

The table below reflects the activity related to the acquisitions and dispositions of our animal hospitals and laboratories during the nine months ended September 30, 2013 and 2012, respectively:

	Nine Months Ended September 30,	
Animal Hospitals:	2013	2012
Animal Hospital acquisitions, excluding Associate Veterinary Clinics (1981) LTD ("AVC")	14	24
Acquisitions, merged	(2)	(4)
AVC acquisition	—	44
Sold, closed or merged	(15)	(4)
Net (decrease) increase	(3)	60
Laboratories:		
Acquisitions	1	—
Created	—	2
Net increase	1	2

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VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
September 30, 2013
(Unaudited)

4. Acquisitions, continued

Animal Hospital and Laboratory Acquisitions, excluding 2012 acquisition of AVC

The following table summarizes the aggregate consideration for our independent animal hospitals, excluding AVC, and one laboratory acquired during the nine months ended September 30, 2013 and 2012, respectively, and the preliminary allocation of the acquisition price (in thousands):

	Nine Months Ended September 30,	
	2013	2012
Consideration:		
Cash	$39,640	$51,744
Cash paid to debt holders	2,360	—
Holdbacks	892	1,475
Earnout contingent consideration	1,120	934
Fair value of total consideration transferred	$44,012	$54,153
Allocation of the Purchase Price:		
Tangible assets	$13,494	$1,995
Identifiable intangible assets	12,774	9,184
Goodwill [1]	32,557	42,974
Other liabilities assumed	(9,407)	—
	$49,418	$54,153
Noncontrolling interest	(5,406)	—
Total	$44,012	$54,153

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(1) We expect that $12.9 million and $40.0 million of the goodwill recorded for these acquisitions, as of September 30, 2013 and 2012, respectively, will be deductible for income tax purposes.

The allocation of the purchase price is preliminary, because certain items have not been completed or finalized, including but not limited to, the valuation of tangible and intangible assets.

In addition to the purchase price listed above, we made cash payments for real estate acquired in connection with our purchase of animal hospitals totaling $1.2 million for the nine months ended September 30, 2013. There were $1.6 million in cash payments made for real estate for the nine months ended September 30, 2012.

2012 AVC Investment

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

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VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
September 30, 2013
(Unaudited)

4. Acquisitions, continued

The AVC investment accounting was finalized during the first quarter of 2013. The following table summarizes the total investment and the final allocation of the investment in AVC (in thousands):

Consideration:	
Cash	$48,819
Cash paid to debt holders	25,915
Fair value of total consideration transferred, net of cash acquired	$74,734
Allocation of the Purchase Price:	
Tangible assets	$11,694
Identifiable intangible assets [1]	25,170
Goodwill [2]	79,707
Other liabilities assumed	(21,826)
	94,745
Noncontrolling interest	(8,161)
Fair value of pre-existing investment in AVC	(11,850)
Total	$74,734

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(1) Identifiable intangible assets include customer relationships, trademarks and covenants-not-to-compete. The weighted-average amortization period for total identifiable intangible assets is approximately six years. This consists of amortization periods of five years for customer-related intangible assets, ten years for trademarks and three years for covenants-not-to-compete.

(2) As of September 30, 2013, we expect that approximately $362,000 of the goodwill recorded for this acquisition will be deductible for income tax purposes.

AVC is reported within our Animal Hospital reportable segment.

2012 ThinkPets, Inc ("ThinkPets")

On February 1, 2012, we acquired a 100% interest in ThinkPets for $21 million, payable by delivery of 473,389 shares of VCA common stock and $10.5 million in cash. Subsequent to the acquisition, we merged the operations of ThinkPets with Vetstreet. Our condensed, consolidated financial statements reflect the operating results of ThinkPets since February 1, 2012 reported within our "All Other" category in our segment disclosures.

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
September 30, 2013
(Unaudited)

4. Acquisitions, continued

The ThinkPets acquisition accounting was finalized during the first quarter of 2013. The following table summarizes the total purchase price and the final allocation of the investment in ThinkPets (in thousands):

Consideration:	
Cash	$7,468
Issuance of common stock for acquisitions	10,500
Holdback	1,050
Fair value of total consideration transferred, net of cash acquired	$19,018

Allocation of the Purchase Price:	
Tangible assets	$2,093
Identifiable intangible assets [1]	7,221
Goodwill [2]	12,155
Other liabilities assumed	(2,451)
Total	$19,018

(1) Identifiable intangible assets include customer relationships, contracts and trademarks. The weighted average amortization period for total identifiable intangible assets is approximately eight years. This consists of amortization periods of nine years for customer-related intangible assets, four years for technology contracts and two years for trademarks.

(2) As of September 30, 2013, we expect that approximately $821,000 of the goodwill recorded for this acquisition will be deductible for income tax purposes.

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
September 30, 2013
(Unaudited)

5. Other Accrued Liabilities

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

	As of September 30, 2013	As of December 31, 2012
Deferred revenue	$10,340	$10,811
Accrued health insurance	5,897	6,409
Deferred rent	4,294	3,604
Accrued other insurance	4,236	3,799
Miscellaneous accrued taxes(1)	4,090	3,485
Accrued workers' compensation	5,980	3,570
Holdbacks and earnouts	4,042	3,599
Customer deposits	2,872	3,140
Accrued consulting fees	2,943	3,114
Accrued lease payments	2,992	888
Other	16,128	14,712
	$63,814	$57,131

(1) Includes property, sales and use taxes.

6. Fair Value Measurements

Fair Value of Financial Instruments

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

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

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

Long-Term Debt. The fair value of debt at September 30, 2013 and December 31, 2012 is based upon the ask price quoted from an external source, which is considered a Level 2 input.

VCA Antech, Inc. and Subsidiaries
Notes to Condensed, Consolidated Financial Statements (Continued)
September 30, 2013
(Unaudited)

6. Fair Value Measurements, continued

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

	As of September 30, 2013		As of December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Variable-rate long-term debt	$568,750	$568,750	$592,422	$592,422

At September 30, 2013, we did not have any material applicable nonrecurring measurements of nonfinancial assets and nonfinancial liabilities.
During the quarter ended December 31, 2012, Vetstreet's goodwill was written down to its implied fair value. Vetstreet's goodwill balance as of December 31, 2012 was $8.8 million. Additionally, during the quarter ended December 31, 2012, Vetstreet's long-lived assets were written down to their estimated fair value. Vetstreet's long-lived assets balance as of December 31, 2012 was $28.7 million.

7. Share-Based Compensation
Stock Option Activity
A summary of our stock option activity for the nine months ended September 30, 2013 is as follows (in thousands):

	Stock Options	Weighted-Average Exercise Price
Outstanding at December 31, 2012	2,181	$17.20
Exercised	(912)	$16.82
Expired	(36)	$30.70
Canceled	(24)	$16.21
Outstanding at September 30, 2013	1,209	$17.11
Exercisable at September 30, 2013	472	$16.69
Vested and expected to vest at September 30, 2013	1,191	$17.12

There were no stock options granted during the nine months ended September 30, 2013. The aggregate intrinsic value of our stock options exercised during the three and nine months ended September 30, 2013 was $7.5 million and $9.7 million, respectively and the actual tax benefit realized on options exercised during these periods was $3.0 million and $3.8 million, respectively.
At September 30, 2013 there was $4.1 million of total unrecognized compensation cost related to our stock options. This cost is expected to be recognized over a weighted-average period of 2.4 years.
The compensation cost charged against income, for stock options for the three months ended September 30, 2013 and 2012, was $436,000 and $362,000, respectively. The corresponding income tax benefit recognized was $171,000 and $142,000, for the three months ended September 30, 2013 and 2012, respectively.
The compensation cost charged against income, for stock options for the nine months ended September 30, 2013 and 2012, was $1.5 million and $1.1 million, respectively. The corresponding income tax benefit recognized was $599,000 and $433,000, for the nine months ended September 30, 2013 and 2012, respectively.

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7. Share-Based Compensation, continued

Nonvested Stock Activity

During the nine months ended September 30, 2013, 12,052 shares of nonvested common stock were granted to our directors representing their annual grant. Assuming continued service through each vesting date, these awards will vest in three equal annual installments beginning May 2014 to May 2016.

Total compensation cost charged against income related to nonvested stock awards was $1.8 million and $2.1 million, for the three months ended September 30, 2013 and 2012, respectively. The corresponding income tax benefit recognized in the income statement was $700,000 and $805,000, for the three months ended September 30, 2013 and 2012, respectively.

Total compensation cost charged against income related to nonvested stock awards was $6.7 million and $9.1 million, for the nine months ended September 30, 2013 and 2012, respectively. The corresponding income tax benefit recognized in the income statement was $2.6 million and $3.6 million, for the nine months ended September 30, 2013 and 2012, respectively.

At September 30, 2013, there was $12.1 million of unrecognized compensation cost related to these nonvested shares, which will be recognized over a weighted-average period of 2.3 years. A summary of our nonvested stock activity for the nine months ended September 30, 2013 is as follows (in thousands, except per share amounts):

	Shares	Grant Date Weighted-Average Fair Value Per Share
Outstanding at December 31, 2012	1,451	$19.90
Granted	12	$24.89
Vested	(362)	$20.25
Outstanding at September 30, 2013	1,101	$19.84

Restricted Stock Unit Activity

During the nine months ended September 30, 2013, we granted 292,478 performance based restricted stock units ("RSUs") to our executive officers representing the right to receive one share of common stock. These RSUs will be earned upon achievement of the applicable performance criteria during the performance periods, from October 1, 2013 through December 31, 2015, as set forth in the 2013 equity performance award agreements. Assuming achievement of the required performance conditions and continued service through each vesting date, these awards will vest in four equal annual installments beginning September 2014 through September 2017.

Total compensation cost charged against income related to RSU awards was $696,000 and $279,000 for the three months ended September 30, 2013 and 2012, respectively. The corresponding income tax benefit recognized in the income statement was $273,000 and $109,000, for the three months ended September 30, 2013 and 2012, respectively.

Total compensation cost charged against income related to RSU awards was $2.1 million and $279,000 for the nine months ended September 30, 2013 and 2012, respectively. The corresponding income tax benefit recognized in the income statement was $806,000 and$109,000, for the nine months ended September 30, 2013 and 2012, respectively.

At September 30, 2013, there was $10.7 million of unrecognized compensation cost related to these RSUs, which will be recognized over a weighted-average period of 3.7 years.

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8.Calculation of Earnings per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income attributable to VCA Antech, Inc	$40,647	$34,037	$112,794	$103,602
Weighted-average common shares outstanding:				
Basic	88,834	87,773	88,583	87,554
Effect of dilutive potential common shares:				
Stock options	310	461	318	523
Nonvested shares and units	701	420	758	512
Diluted	89,845	88,654	89,659	88,589
Basic earnings per share	$0.46	$0.39	$1.27	$1.18
Diluted earnings per share	$0.45	$0.38	$1.26	$1.17

There were no potential common shares that were excluded from the computation of diluted earnings per share for the three months ended September 30, 2013. For the three months ended September 30, 2012, potential common shares of 1,220,547 were excluded from the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

For the nine months ended September 30, 2013 and 2012, potential common shares of 23,538 and 1,100,645 respectively, were excluded from the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

9.Lines of Business

Our business is divided into four operating segments: Animal Hospital, Laboratory, Medical Technology and Vetstreet. Our operating segments are managed separately because each is a distinct and different business venture with unique challenges, risks and rewards.

Our reportable segments are aggregated into two reportable segments, "Animal Hospital" and "Laboratory". Our Animal Hospital reportable segment provides veterinary services for companion animals and sells related retail and pharmaceutical products. Our Laboratory reportable segment provides diagnostic laboratory testing services for veterinarians, both associated with our animal hospitals and those independent of us. Our Medical Technology and Vetstreet operating segments do not meet the quantitative requirements for separate reportable segments and are included in our "All Other" category. Our Medical Technology segment sells digital radiography and ultrasound imaging equipment, related computer hardware, software and ancillary services to the veterinary market and our Vetstreet segment provides online communications, professional education, marketing solutions to the veterinary community and an ecommerce platform for independent animal hospitals. We also operate a corporate office that provides general and administrative support services for our segments.

The accounting policies of our segments are essentially the same as those described in the summary of significant accounting policies included in our 2012 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.

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9. Lines of Business, continued

The segment information presented below includes a reclassification to eliminate discounts on certain Laboratory contracts that were previously allocated to the All Other operating segment from Eliminations in the prior year financial data. These reclasses better represent the corresponding discounts and thus the operating results of our standalone entities. These changes in segment reporting only revised the presentation within the table below and did not impact our condensed consolidated financial statements for any period presented. The segment information for the three and nine months ended September 30, 2012 has been adjusted retrospectively to conform to the current period presentation.

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 September 30, 2013						
External revenue	$368,868	$72,877	$21,482	$—	$828	$464,055
Intercompany revenue	—	13,583	5,980	—	(19,563)	—
Total revenue	368,868	86,460	27,462	—	(18,735)	464,055
Direct costs	308,029	45,650	17,456	—	(17,757)	353,378
Gross profit	60,839	40,810	10,006	—	(978)	110,677
Selling, general and administrative expense	8,678	7,921	7,618	14,530	—	38,747
Operating income (loss) before charges	52,161	32,889	2,388	(14,530)	(978)	71,930
Net (gain) loss on sale or disposal of assets	(110)	11	—	(10)	—	(109)
Operating income (loss)	$52,271	$32,878	$2,388	$(14,520)	$(978)	$72,039
Depreciation and amortization	$15,037	$2,554	$			