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Have Veterinary Practices Lost Flea, Tick and Heartworm Revenue to Internet and Retail Channels?

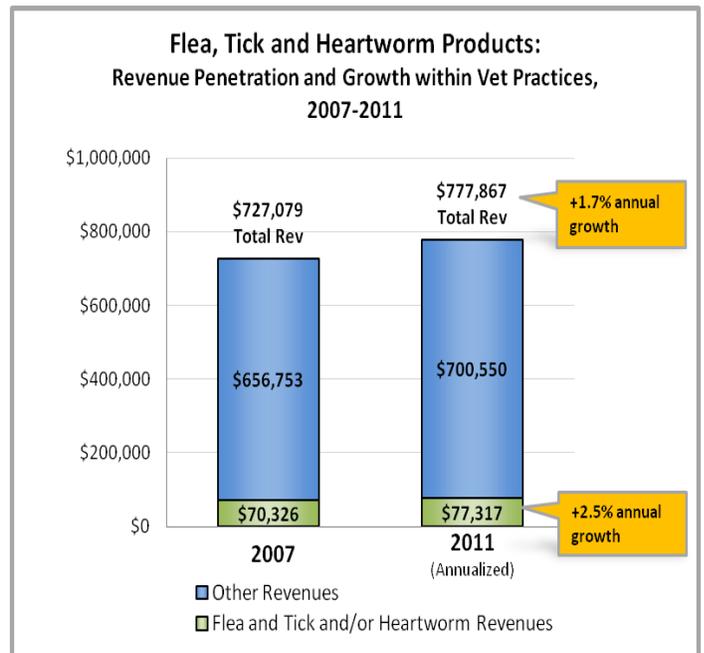
It has become conventional wisdom: the Internet is killing vet product sales. To quantify our understanding of this 'truism', VPP conducted a market research study surveying over 250 veterinary practices. While we asked vets' opinions, we also analyzed actual practice revenues to tell the real story.

Many veterinary practice owners we surveyed believe that Internet and retail sales of flea, tick and heartworm (FTH) medications have had a negative impact on their business:

- 80% believe that they have lost flea, tick and heartworm revenue
- 35% also thought client visits had gone down.

But the actual revenues of the very same practices from 2007 to 2011 tell a different story. FTH revenues have been growing at a 2.4% annual rate, compared to only a 1.7% annual growth rate for practice revenues over the same 4 year period, and FTH revenues actually increased slightly as a percentage of total revenue to 9.9% in 2011 from 9.7% in 2007.

We focused on revenues from these products because the actual unit sales data is difficult to obtain. But it is reasonable to conclude that unit volume of these medications has increased even more than the reported 2.4% growth in revenue from these products, given that (1) 42% of practice owners told us they



lowered their prices to match internet pricing and (2) manufacturers began giving clients 1 or more free months of medication when they buy from a DVM in the last 2 years.

What is going on here? Despite all the additional competition, are vet practices actually selling more FTH medication? Indeed, the data from a cross-section of practices tells us that sales of FTH medications are growing at a faster rate than overall practice revenues.

It appears that the availability of these medications in internet and retail channels is actually expanding the overall market size, so much so that it is positively impacting

veterinary practices. While there has been a huge increase in sales of these medications through internet and retail channels, the increased pet owner awareness of the benefits of these products has also driven growth in sales through veterinary practices. This market expansion is a huge benefit for the drug companies, but has also turned out to be a benefit for veterinary practices.

Are all the manufacturers benefiting equally from the revenue growth within the veterinary practices? See the next page!

“Sales of flea, tick and heartworm medications are growing at a faster rate than overall practice revenues.”

For survey participant demographics and methodology, see page 4

Manufacturer Market Share in Vet Practices

Are all the manufacturers benefiting equally from the revenue growth within the veterinary practices? No! There are significant shifts in which branded FTH medications are being sold by veterinary practices. The chart below highlights the manufacturers who are winning and losing market share within the veterinary practices.

FTH market leader, Merial, has lost over 14% market share of vet practice sales over the past 3 years as DVMs react to the wide availability of their products in the internet and retail channels. The other major manufacturers' products that are widely available on the internet and through retail stores have seen subtle market share shifts (except for Virbac's Iverhart which has almost doubled its small market share).

The big winners in the vet practice market share battle are the manufacturers who keep a tight leash on their products, not allowing them

to be sold through the internet or retail channels. Veterinarians and their clients have rewarded Elanco's Comfortis and Trifexis brands with a 400% increase in share from 2.3% to almost 12%, making them the 3rd biggest player with veterinary practices behind Merial and Novartis (and ahead of both Bayer and Pfizer). Summit's Vectra 3D brand also saw impressive growth.

Veterinarians are doing less business with drug companies whose products are widely available in internet and in retail channels. 85% of practice owners say the online and retail distribution of products that used to be only sold in vet offices has negatively impacted their view of the manufacturers. "We make their product a success, then they take it OTC," was a common theme expressed by DVMs.

However, DVMs are rapidly switching allegiance to manufacturers whose products are only sold

through veterinary practices AND veterinary practices are benefiting from increased revenues and unit sales as the overall market expands.

"Veterinarians are doing less business with drug companies whose products are widely available in internet and in retail channels."

**Flea, Tick and Heartworm Products:
Share Changes within Vet Practices, 2008-2011**

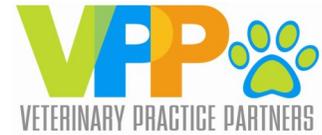
Products Widely Available on the Internet

2008-11 % Change

Manufacturer (Products)	2008 Share	2011 Share	2008-11 % Change
Merial (Frontline, Heartguard)	53.0%	38.6%	-14.4%
Novartis (Interceptor, Sentinel)	22.5%	23.0%	+0.5%
Bayer (Advantage Multi, Advantix)	8.1%	7.8%	-0.3%
Pfizer (ProMeris, Revolution)	8.7%	6.4%	-2.3%
Virbac (Iverhart)	2.4%	4.5%	+2.1%
Total Internet Products	94.7%	80.3%	-14.4%

■ 2008
■ 2011

Elanco (Comfortis, Trifexis)	2.3%	11.9%	+9.7%
Summit (Vectra 3D)	1.4%	3.9%	+2.5%
Total Non-Internet Products	3.7%	15.8%	+12.1%



Veterinary Practice Market Growth Statistics

We expect to produce this newsletter at least twice a year with meaningful analysis of business issues impacting veterinary practices. As part of our commitment to educating veterinarians on market trends, we will also include market growth data in each issue so you can compare your practice with others within the industry.

The first chart below shows quarterly revenue growth and revenue per invoice growth. These are two key measures of practice performance that most owners monitor and we provide information from our proxy for the market (over 250 veterinary practices) as well as VCA and IDEXX reported data.

While revenues grew in late 2010 and early 2011, market growth has slowed in the past 6 months which is likely due to continued uncertainty about the economy. These trends reflect the uneven economic

recovery and the continued low levels of consumer confidence.

The market share by manufacturer varies considerably across various regions of the country with Bayer having strength in the northeast (20% share vs. 8% nationally), Elanco's strength is in the South (17% share vs. 12% nationally) and Pfizer and Virbac have strong customer bases in the West. Elanco and Pfizer are weakest in the Northeast while Bayer is underperforming in the west relative to its national market share.

The second chart tracks monthly revenue and revenue growth trends and highlights the variability in monthly growth patterns. The total revenues highlight the seasonality of the business, with October 2010 through February 2011 monthly revenue averaging \$66,000 while March 2011 through September 2011 averaged \$76,000, or 16%

higher revenue. It should be noted that compared to last year, revenues grew more rapidly in the winter (Q4 2010 and Q1 2011) than over the next six month period.

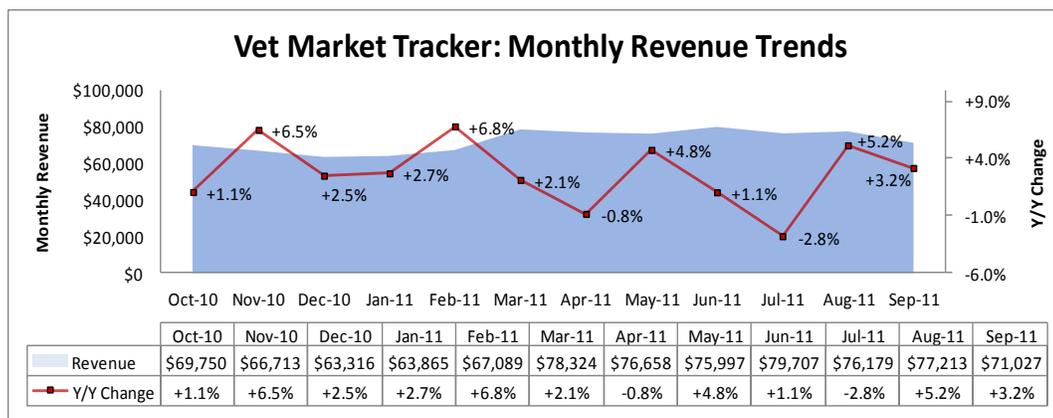
The monthly revenue growth is materially more varied than the quarterly data because monthly information is impacted by the calendar (i.e. July 2011 had 5 Sunday's while July 2010 only had 4) and the weather (snow storms in one year and not in another). We tend to focus on quarterly growth figures which provide a better overall picture than monthly figures but wanted to show the monthly data as well.

“Market growth has slowed a bit over the past 6 months which is likely due to continued uncertainty with the economy.”

Year-over-Year Growth							
Same Store Revenue Growth	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11
VCA	-1.6%	-2.0%	-4.0%	-2.2%	-2.2%	-1.9%	1.0%
Market (a)	1.2%	0.8%	1.2%	3.3%	3.8%	1.6%	1.7%
IDEXX - Cornerstone (b)			1.2%	3.0%	2.0%	2.0%	3.0%

Year-over-Year Growth							
Revenues per Visit	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11
VCA	3.3%	2.6%	1.0%	1.8%	2.4%	2.4%	3.7%
Market (a)	2.2%	2.2%	1.2%	3.0%	4.9%	2.9%	2.4%

(a) Market is the average revenue growth from practices surveyed by VPP's market research group
 (b) Data reported by IDEXX relating to practices using Cornerstone software



Survey Methodology

The survey was conducted by a New York City-based healthcare market research firm. The survey questions presented in this newsletter were part of a larger ongoing market tracking study which has been conducted for several years to assess global changes and trends impacting Veterinarian practices. Practice-wide metrics captured in this survey, including monthly revenue data, is provided directly from electronic practice management systems. The survey is not affiliated with any Veterinarian product manufacturer.

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Practices were recruited randomly from a universe listing of Veterinarian practices provided by InfoUSA, a leading provider of medical databases. During the period of Oct 4th-24th, 2011 n=264 Veterinarian practices participated in this survey, of which 57% were Veterinarian practice owners, 14% were associate DVMs, 26% were practice managers and 4% were Veterinarian technicians. Both the overall practice sample and Veterinarian practice owner subset represent a good regional cross section of the country.

The practices surveyed are very similar to the national averages for practice revenue.

The national averages for demographics and practice revenue were obtained from InfoUSA. It should be noted that all the data is from general practices and we have not looked at the specialty market.

Region	All Practices in Sample	Vet Owners	Universe of Vet Practices in the US (N=32,755)
New England	3%	2%	5%
Middle Atlantic	6%	6%	10%
East North Central	21%	25%	15%
West North Central	16%	19%	10%
South Atlantic	17%	11%	19%
East South Central	5%	3%	7%
West South Central	9%	10%	13%
Mountain	10%	13%	8%
Pacific	12%	10%	14%

Practice Revenue	All Practices in Sample	Vet Owners	Universe of Vet Practices in the US (N=32,755)
Under \$700,000	52%	57%	59%
\$700k to <\$1.5 million	34%	32%	27%
\$1.5 million - <\$3 million	14%	11%	11%
Over \$3 million	0%	0%	4%

About Veterinary Practice Partners

Veterinary Practice Partners was founded in 2011, to create joint ventures with veterinary hospitals. VPP's leadership has seen the partnership model thrive in human healthcare where business people and doctors own healthcare facilities together. This approach, when applied to veterinary practices, creates a clinical and business environment that puts patient care first, while implementing business processes that result in a financially successful venture.

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