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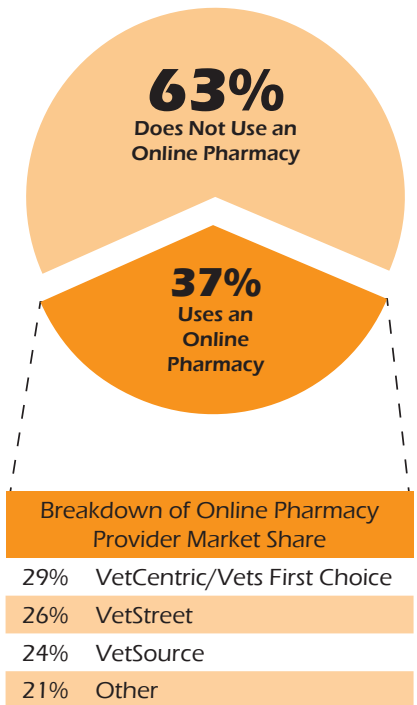
Online Pharmacies: Revenue Opportunity or Headache?

Veterinary practices are now regularly competing against internet companies and big box retailers for their clients' purchases of prescription drugs, specifically, flea, tick and heartworm medications. One popular way for individual practices to counter the threats from these competitors is to establish an on-line pharmacy that should (i) lower inventory costs, (ii) expand product selection and (iii) price competitively against the online and bricks-and-mortar retailers. The question is – has the online pharmacy been successful for veterinary practices? How does a practice effectively compete against the likes of Wal-Mart and Target?

In our survey of over 250 veterinary practices, the answer seems to be that online pharmacies are NOT being used effectively in this battle. To be frank, we were surprised at how little the online pharmacies were being used. More research needs to be done on the specific reasons but there are clearly opportunities for both veterinary practices and the online pharmacy operators to grow this segment.

The highlights of VPP's proprietary third-party market research include:

- Only 37% of practices have set up online stores, a fairly low penetration rate. These rates were similar for both large and small practices.
- Of those practices with a pharmacy, 70% are generating under \$500/month in revenue and 83% are generating under \$1000/month.
- The online pharmacy market has evolved into three major players: VetStreet, VetSource and Vets First Choice (which bought VetCentric in 2012), with a combined share of 80%+.



- The DVMs view their online pharmacy profit margins as slim, with 41% saying margins are below 10%. It is important to note that there is a clear difference in profitability based on the online pharmacy provider being utilized.
- VetStreet clients see their profit margins as materially higher, with over 50% viewing margins above 10% and only 26% saying margins are below 10%. By contrast, 50%+ of Vets First Choice and VetSource clients report profit margins under 10% (see chart on page 2).
- Profitability and satisfaction are not necessarily related as VetSource has the highest rate of clients that are 'satisfied' or 'somewhat satisfied' of the three providers.

Based on survey responses, practices are realizing margins, on average, of 10%. This compares

"Of those practices with a pharmacy, 70% are generating under \$500/month in revenue"

For survey participant demographics and study methodology, see page 4

poorly with in-clinic sales of flea, tick and heartworm medications that average in excess of 40%. One clear reason for the disparity is that practices are not generating enough volume to diminish the impact of fixed monthly administration costs charged by certain providers.

Estimated Online Pharmacy Profit Margin by Vendor

	Total	Vetcentric	Vetsource	Vetstreet
Over 10%	46%	43%	26%	52%
Under 10%	41%	54%	52%	26%
Not Sure	13%	4%	22%	22%

Conclusions

Is the online pharmacy a waste of time for practices? Is it inherently an ineffective tool? Considering 5% of the practices surveyed reported generating over \$2000/month in online pharmacy revenues, we don't think so. In fact, we see significant opportunities for both veterinary practice owners and the three remaining major players in the space to grow this business significantly over the next couple of years. Success, as we see it, will all boil down to their ability to better educate clients on the convenience of the service and their ability to best promote the service to a wider audience than is currently aware of the offering.

From our experience, practices that commit to the online pharmacy, and train staff to educate clients on its benefits, are the ones that best protect against revenue leaving the practice for other online competitors or the big box retailers. Having DVMs, technicians and reception staff understanding when and how to discuss the online store with a client, and having the ability to walk a client through the experience, is critical to the program's success.

Furthermore, the online pharmacy vendors themselves face a significant opportunity, though not without risk. Currently, providers are collecting both fixed monthly fees (costs which may not always be included in a practice owner's view of profitability), as well as per transaction fees. However, with such paltry volumes at the practice level, the online pharmacies do not have to spend much on utilization, likely creating very high margins for their offerings from the monthly fees alone. However, considering the data's disconnect between profitability and practice owner satisfaction, we believe that the online pharmacy that actually makes the investment in educating practice owners on how to better use their online stores will ultimately lead the space.

AAHA Accreditation - Does It Affect the Bottom Line?

The American Animal Hospital Association provides the only true national standard for quality of care in the veterinary industry. We decided to survey practices regarding their impressions of AAHA. The results were not surprising.

While AAHA states that 15% of practices are accredited, our sample included 21% of hospitals with accreditation, with another 49% competing against an accredited hospital. The key drivers for a practice to become accredited are (i) practice better medicine, 59% and (ii) differentiate the practice 28%. However, only 25% of practices price their services higher than competitors because they are accredited. Additionally, feedback from pet owners about the accreditation is minimal, with only 6% of accredited hospitals saying clients seek out AAHA and only 23% believing clients feel good about going to an AAHA practice.

In asking practices that compete against AAHA clinics in their area, 81% believed that they were not at any disadvantage because of the lack of accreditation and only 1% felt they actually lost

“Feedback from clients about the accreditation is minimal, with only 6% of accredited hospitals saying clients seek out AAHA”

business to the accredited clinic.

Conclusion

Our view is that the AAHA accreditation is a worthwhile standard to achieve for a clinic. It will help a practice recruit and retain higher quality DVMs and staff who want to be held to a high standard. We also believe it is important for AAHA clinics to educate and promote the standards more effectively to their own clients, which would help with retention. Finally, AAHA is clearly making efforts to educate pet owners about the benefits of the hospitals with the accreditation and they need to continue that mission. When AAHA can demonstrate that a material number of pet owners (5% or more) are making decisions based on AAHA accreditation, then there will also be a clear financial benefit for more practices to pursue accreditation.

Market Growth Statistics

As part of our commitment to educating veterinarians on market trends, we include market growth data in each issue so you can compare your practice with industry benchmarks.

We analyze revenue growth and revenue per invoice, including data from our survey of over 250 veterinary practices, as well as VCA and IDEXX's publicly reported data.

The end of 2012 showed some decline in revenue growth from the strong growth in Q1 2012. The market grew nearly 7% in Q1 2012, but slowed to roughly 4% to end the year. VCA continues to lag the market by 3-4% percent. IDEXX Cornerstone data consistently outperforms our market data by 1-2%. Compared to 2011, 2012 produced a strong year for veterinary practices with the overall revenue growth returning to its pre-recession levels of 4%+, an indication that pet owners have the resources to provide care for their pets.

**“Compared to 2011,
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Year-over-Year Revenue Growth

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
VCA Antech	-2.2%	-1.9%	1.0%	1.1%	3.5%	0.2%	1.1%	1.6%
Market*	0.6%	1.0%	1.5%	0.9%	6.7%	3.7%	4.2%	4.0%
IDEXX (Cornerstone)**	2.0%	2.0%	3.0%	3.5%	7.0%	5.5%	6.0%	5.0%

From a revenue per visit perspective, the market grew just over 2.5% to close the year, slightly behind VCA. This is a metric that VCA tends to outperform the market (or at a similar level to the market) over the past 3 years. This metric represent the ability of practices to either increase pricing or have clients utilize additional services in each visit and is an important measure to track the ability of practices to pass cost increases (labor and supply costs) to their clients. While VCA tends to lag the market in same store growth it has tended to outperform the market in the revenue per visit metric, showing that it has been able to pass on price increases to those customers that continue to return to their clinics, with fewer clients returning to their clinics.

Year-over-Year Revenue/Visit Growth

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
VCA Antech	2.4%	2.4%	3.7%	4.4%	2.9%	2.2%	2.7%	4.3%
Market*	0.9%	2.3%	1.7%	-0.1%	1.0%	-0.3%	2.4%	2.6%

*Market is the average revenue growth from practices surveyed by VPP's market research group. The historical data reflects only those practices that have completed the most recent quarterly survey so the data has changed from prior VETPulse issues.

**Data reported by IDEXX relating to practices using its Cornerstone practice management software.

Survey Methodology

The survey was conducted by a New York City-based 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 changes and trends impacting veterinary 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 in any manner with any veterinary product manufacturer.

“The survey is not affiliated in any manner with any veterinary product manufacturer.”

Practices were recruited randomly from a universe listing of veterinary practices provided by InfoUSA, a leading provider of medical databases. During October 2012, 257 separate veterinary practices participated in this survey, of which 62% were veterinary practice owners, 25% were

office managers, and 13% were non-owner DVMs or had other titles. The practices participating in this research represent a good regional cross section of the country as illustrated by the table above. Additionally, from a total practice revenue standpoint, those surveyed are very similar to the national averages:

Region	All Practices in Sample Set (n=257)	Universe of Practices in US (n=32,755)
New England	5%	5%
Middle Atlantic	6%	10%
East North Central	21%	15%
West North Central	14%	10%
South Atlantic	18%	19%
East South Central	6%	7%
West South Central	9%	13%
Mountain	9%	8%
Pacific	12%	14%

Practice Revenue	All Practices in Sample Set (n=257)	Universe of Practices in US (n=32,755)
Under \$700,000	49%	59%
\$700k to <\$1.5 million	36%	27%
\$1.5 million - <\$3 million	14%	11%
Over \$3 million	1%	4%



Rich Lester, CEO

About Veterinary Practice Partners

VPP is a management company in the veterinary industry; we buy ownership stakes in practices and then work behind the scenes to manage and grow those practices. VPP handles marketing, accounting, human resources and vendor contracting so DVMs can focus on patient care. Working together as partners, VPP and the DVMs make all major business decisions.

For more information on our unique approach to managing veterinary practices, and to learn how we might be able to help your practice meet its goals, please contact us:

- Visit our website at www.vetpartners.com
- Give us a call at **866-VET-PART (838-7278)**
- Send us an e-mail at info@vetpartners.com