Veterinary Services in Canada

Executive Summary
Roll – Up Strategy

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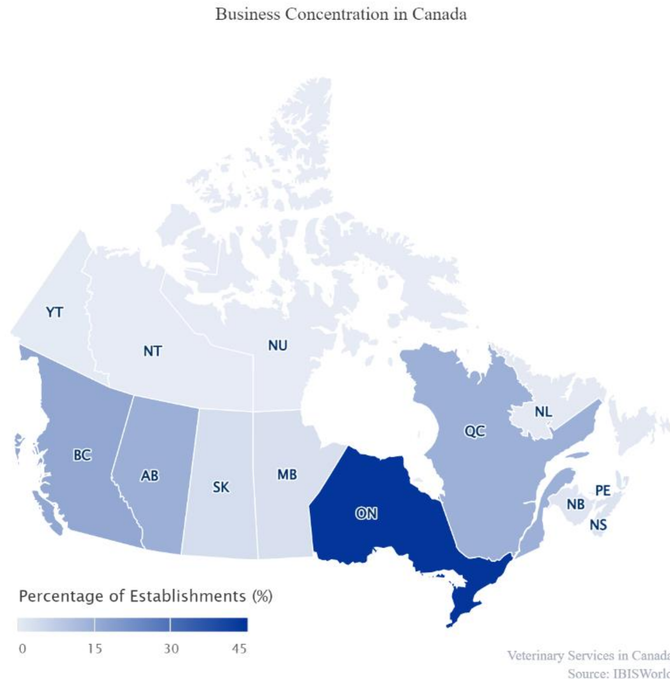
Executive Summary

The Canadian Veterinary Service Industry is a $4.6 billion market revenue opportunity that is highly fragmented and ripe for consolidation. The largest player in Canada only represents 6.7% of industry revenue. Veterinary services will benefit from rising pet adoption, technological advancements, specialization commanding higher margins, and increased focus on keeping agricultural livestock healthy. 58% of Canadian households report they own at least one companion animal, with the total number of dogs and cats amounting to 7.7 million and 8.1 million respectively. Skilled labor shortages driven by high costs of education means new graduates will find it difficult to start their own practice. Consolidated practices benefit from leveraging administrative and marketing functions and increased margins from economies of scale. With a relatively small number of competitive private equity sponsors in the country and aging veterinarians, the industry is looking for exits and this venture aims to provide them with one.

Veterinarian Concentration in Canada



Market Overview

The Canadian Veterinary Service industry is a $4.6 billion market that is highly fragmented and ripe for consolidation. Unlike international markets, Canadian veterinary practices are still dominated by individual practitioners, with an estimated 5,594 individual establishments, according to IBISWorld. 60% of industry operators employ 10 employees or fewer. VCA Antech Inc. is the only major player, with a total market share of 6.7% representing roughly $330 million in total revenues. In 5 years to 2025, industry revenues are forecast to grow at a CAGR of 2.6% to $5.2 billion.

Revenues are broken down into the following:

Key Statistics (2020 Include Effects of COVID)

	2020	5YR Growth	2025E	5YR Growth
Revenue ($M)	4,592	0.4%	5,215	2.6%
Profit ($M)	505.1	-4.2%		
Profit Margin	11.0%	-2.9%		
Businesses	5,594	0.5%	6,386	1.6%
Employment	42,981	2.2%	47,810	1.8%

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Nonsurgical procedures (26.6% of industry revenues): This segment includes vaccinations, treatment of wounds, cleaning of infection prone areas (such as ears). It also includes prevention practices such as lyme disease vaccination and topical flea treatment.

Routine Exams (23.7% of industry revenue): Tests include checking animal ears, temperature, listening to heart rate, and the monitoring of physical injuries like a broken bone. Routine exams are typically biannual and generate a flat fee. According to the Canadian Annual Health Institute (CAHI), veterinarians are the most frequently consulted source of information, and the desire for pet wellness has bolstered this service's segment.

Laboratory and Diagnostics Testing (15.8% of revenues): Diagnostics include radiography and ultrasound machines (ie: dental radiographs to identify gum & dental diseases before severe symptoms emerge).

Surgical Procedures (14.8% of revenues): This includes the treatment of broken bones, removal of tumors, insertion of tracking devices, and removals of foreign objects the pet has swallowed.

Pet Products & Food (11.1% of revenues): Veterinarians sell specialty food that is not available in pet stores to stimulate demand. However, this service segment has declined in revenues from increased competition by big box stores, grocery stores, and alternative retailers carrying animal products such as accessories and dog food. Moreover, products are increasingly available online, such as flea and heartworm medicine. Industry revenues have also been impacted by legislation that have raised fees for veterinarian drug producers, which has been passed down to end consumers.

The industry benefits from low capital intensity as veterinary services are labour intensive, rather than capital intensive. For every $1 spent on labour, $0.03 will be spent on capital. IBISWorld estimates that 50% of industry cost structure consists of wages, which includes administrative functions and veterinarians that will treat the pets. This is because diagnosing and treating animals requires significant knowledge, skill, and education. Taking tests, samples, feeding, grooming, and cleaning animals, as well as payment processing, marketing all requires an extensive labour force. Rent is its second largest cost at 15-20% of cost structure. Pet owners mainly choose veterinary services based on convenience, so it is important that clinics establish offices in areas of high traffic and sufficient disposable income as to attract pet owners on a consistent basis. Moreover, vet locations that are located near pet stores that offer other pet products may provide vets with a competitive advantage. Customers are typically acquired by word of mouth or by convenience, so marketing is a relatively small expense within a practice's budget. Established, trusted practices have the potential to monopolize small geographical areas based on convenience.

The veterinarian industry in Canada also has strict regulatory requirements that make it tough for new entrants. Firstly, veterinarians face intense training and education requirements to obtain licensing. A vet must attend one of 5 accredited universities in Canada or 30 in the US, and train for 6 years to obtain a doctorate in veterinarian medicine. According to Dr. Jeffrey Wichtel, dean of the Ontario Veterinary College (OVC) in Guelph, Ontario, educating vets cost more than educating students in any other field. Tuition, including all-in costs, can be up to $40,000 per year. Once completed, they must pass a 3-part exam and apply for a license in the province the applicant wants to practice in. Licensed vets can only practice in the jurisdiction where they hold their license. The distribution of prescription medicine must be within the province and must have the required amount of information on the patient, including dosage, patient names, and the vet signature on the bottle.

The veterinarian industry also serves three different end markets. In addition to **companion animal practices (CAG) (66% of industry revenues)**, **mixed animal practices (24.6% of industry revenues)** and **farm animal practices (9.4% of industry revenues)** are alternative markets. Mixed animal practices are practices that cater to large animals and exotic companion animals such as snakes and turtles. Farm animal practices have benefited from increased consolidation in agriculture, and the number of livestock animals being produced has increased at a steady but moderate rate. Since practices are in rural areas, one practice has a monopoly over livestock in the area.

Drivers

- **Rising Pet Adoption, Aging Population:** According to the Canadian Animal Health Institute (CAHI), 58% of Canadian households report they own at least one cat or dog. From '18 to '20, the population of dogs have grown from 7.6M to 7.7M while the population of cats have remained flat at 8.1M. Correspondingly, annual household expenditure on pet expenses in Canada has doubled from '10 to '19, representing a CAGR of 5.4%. Veterinary costs are $1,350 and $1,148 annually for dogs and cats respectively, up 62% and 45% respectively since 2012. As companion animals age, they will command more expensive routines and medication. Households will be willing to spend to keep their pets alive as they are increasingly integrated into the household unit. Moreover, a burgeoning elderly human population will lead to an uptick in pet ownership rates as it increases life satisfaction for this demographic.

- **Specialization and Technological Advancements:** Human medical technology is increasingly being used on pets driven by increased spending in R&D by pharmaceutical manufacturers. CT scans, MRIs, organ transplants, pacemakers, radiation therapy, chemotherapy, ultrasounds, surgical and therapeutic lasers, stem cell treatments, and dental radiograph anesthetic monitoring equipment are becoming commonplace among pet procedures. Advancements have made testing cheaper, quicker, and more effective. Vaccinations and drug treatments have become more efficacious as well, which will lead to increased pet lifespans requiring additional expenditure. Practices have began to specialize in fields of animal medicine, including oncology, neurology, cardiology, dermatology, eyecare, gastroenterology, endocrinology, and urology, especially for elderly pets. Veterinarians who specialize typically have higher profit margins.

- **Increased Agriculture Scrutiny:** Increasing concerns with disease in livestock, foodborne illness in meat, and increased regulation has increased demand for agricultural veterinarians. The lower cost of livestock prices and larger herd sizes have risen demand for livestock from farmers, and consequently for veterinarian services. Veterinarian meat inspectors now precede traditional meat inspectors, inspecting diseases, monitoring treatments, and investigating infectious outbreaks from human consumption. This is important to businesses as disease outbreaks affect public perception of meat. Effective treatment will reduce the need for expensive mass eradication techniques as well.

- **US Industry as a Leading Indicator:** Veterinarian practices are consolidating into corporate-owned entities and multi-doctor animal hospitals. These operations create scale that gives them greater access to laboratory and technical resources, shared streamlined processes, information management systems and can be expanded rapidly through M&A. As of 2018, 10% of vet clinics are corporate owned, representing 3,500 of the estimated 35,000 establishments. Households with a dog or cat visit veterinarians 2.6 and 1.6 times per annum respectively (American Veterinary Medical Association). Pet insurance coverage has grown at an annualized rate of 17.2% to 3.1 million pets covered (American Pet Health Insurance Association). Not included in Canada' pet figures is the surge in pet adoption during the pandemic. 30% of Americans adopted a pet during the pandemic according to the Consumer Responses to the Pandemic and Implications for Insurance report. With less regulation, pet owners can also pay for treatments that were once reserved for humans, including 3D printing reconstructions of pet bones for surgical purposes. Years from now, the US market will follow British and Scandanavian markets, where 30-50% of vet practices are corporate-owned. Canada will likely lag the US market in all aspects, presenting an opportunity to enter a relatively untapped market.

Investment Strategy

A tremendous opportunity presents itself to roll-up veterinarian practices. Retiring veterinarians are looking for exits and want to put their practices in capable hands, who will preserve the quality of service and culture. These veterinarians may also want to focus on their practice while leaving administrative and operational issues to the sponsor. Additionally, they will be approaching, at, or beyond retirement age and will be extremely motivated to sell the practice. While there are existing corporate entities looking to acquire practices, *they typically look for multi-veterinarian businesses generating $1.2 million or above in annual revenues, leaving significant white space for a smaller consolidator as 50% of veterinarian clinics do not fall into this category.* Here are some potential value-add activities post-acquisition:

- **Operational Defects:** Post-acquisition, consolidators have often found financial and operational defects, including poor IT systems, outdated software, and ineffective management programs. With many practices, sponsors can streamline software and operational processes used for SG&A and marketing into one back-office function. Scarce labour can then be freed up to focus on pet care rather than administrative duties.

- **Telemedicine:** Some veterinarian clinics offer alternative billing options like memberships, which have an omnichannel offering. Improved telemedicine services can help drive customer engagement and provide a better care experience. Issues that need to be addressed include the monetization of telemedicine services, processing post-telemedicine requests like diagnostic services and prescriptions, having sufficient and trained labor to cover service offerings, and ensuring software is capable of handling proposed features, including medical recordkeeping, integrated customer data, and practice management systems can support it.

- **Improved Service Economics:** Veterinarians have a fixed component of costs, which include laboratory & diagnostic equipment, rent, and wages, and a variable component of costs, which include medical supplies and additional labor. With an expansion in the number of locations, a sponsor could leverage purchasing power to negotiate lower supply prices by purchasing in bulk. By negotiating better prices, vets can increase the profitability of their fixed costs, which require a certain number of visits to cover the costs of equipment. Each incremental visit after breakeven will be accretive. Variable costs can also be managed in turn, with a higher margin on each visit.

We will target candidates across Canada and concentrate on a high population density area, which could be Ontario, Quebec, British Columbia, and Alberta. We will target veterinarians serving Companion Animal Practices as we see pet owners attributing the highest value to their animal's health in this segment. The ideal acquisition candidate will check the following boxes:

- ✓ **Single or multi-vet practice with management urgently looking to retire**
- ✓ **A proximity to population-dense areas with a high level of pet ownership and personal income**
- ✓ **Provision of appropriate facilities that are attractive to customers, reflecting the fact that pets are an integral member of family units**
- ✓ **Good reputation as word-of-mouth business referrals drive business.**
- ✓ **Competitive pricing**
- ✓ **Opportunities for greenfield or brownfield expansion within the area with capacity for more than one practitioner.**
- ✓ **(Optional) Close proximity to pet stores such as PetSmart, who use vets proximal to their physical locations**

Financing will be subject to negotiations; however, the company will be aiming for 100% vendor takebacks. If the seller is not willing, we will consider a mix of vender takeback and debt financing. 100% debt financing is also a possibility. Practitioners can have the option to retain equity to participate in the upside to the transaction and continue to manage the business for three to eighteen months, before new practitioners are brought in.

We will look to roll-up 50-100 veterinarian clinics in the next five years to achieve scale. We will aim for a public offering as there are no pure-play veterinary publicly traded companies. Moreover, with the acquisition of VetStrategy by IVC Evidensia, a European veterinary consolidator and the largest in the world, there are no longer any Canadian-first brands, a key consideration when veterinarians are selling their practices. We will create a trusted Canadian brand that pet owners can go to for an assurance of quality.

Competitive Landscape

While the Canadian industry is highly fragmented, there are several consolidators that may be competitors to roll-up efforts. There are several categories of consolidators in North America:

Veterinarian-led groups that have merged with fellow practices. These operators are patient focused and develop solid networks at the expense of slower growth.

- Mission Veterinary Partners (US and Canada)
    - Founded in 2017 by 2 Veterinarians and Shore Capital Partners acquired a majority interest later that year.
    - Operates 250 hospitals and 125 general practices in 19 states
    - Ownership Agreement: Flexible (Cash buyout, roll-over equity, joint venture, etc)
    - Practice Eligibility Criteria: Revenues greater than $1.5M, three or more veterinarians, modern facility, culture fit

Private equity backed consolidators focused on fast growth, maximizing returns, and M&A.

- VetStrategy (Canada)
    - Founded in 2005, PE-Backed in 2019 by Berkshire Partners
    - Operates 350+ hospitals and 130 practices in all Canadian provinces
    - Practice Eligibility Criteria: Not Disclosed
    - Ownership Agreement: Buyout, Joint Venture Partnership
- National Veterinary Associates (US, Canada, Australia, NZ)
    - Founded in 1997, acquired by JAB Investors (Holding Company) from Ares Management and OMERS in ‘19
    - Operates 1100+ specialty, ER hospitals, and pet resorts in the US, Canada, Australia and NZ
    - Ownership Agreement: Joint Venture Partnership
    - Practice Eligibility Criteria: Culture fit, financial criteria not disclosed

Wealthy family enterprises (US-based Mars and Canadian Desmarais) looking to diversify sources of income.

- VCA Antech (US and Canada)
    - Founded by three partners in 1986 and acquired by Mars Inc (pet confectionary manufacturer) in 2017. Operates as a separate entity under VCA Antech.
    - Operates over 1000 hospitals across the US, Canada, Brazil, Japan and 35 Pet CancerCare Centers
    - Ownership Agreement: 100% sale (cash)
    - Practice Eligibility Criteria: Solid growth, top-notch medicine, and revenue over 1.3 million

Veterinarian groups buy store-based clinics (VIP Pet Care in Walmart, Thrive & Pathway Vet Alliance brand in Petco) which increases affordability and benefits from combining retail and vet care at multiple locations. Vet services are not offered in pet stores in Canada.

In general, all consolidators offer centralized finance and accounting (payables, payroll, etc), HR, talent acquisition, and marketing services, new equipment purchases and IT support, profit sharing, and benefits management. Medical autonomy, culture preservation, and brand identity are also major sticking points.

Risks

- **Recession:** There are multiple leading indicators that are flashing recession warnings. As pet ownership will increase with disposable income, pet adoption may be hampered during a recession. However, revenue volatility will typically stay stable as pet owners will still want to maintain and improve the health of their companion animals through regular check-ups and health examinations. Moreover, pet adoption will continue to increase as disposable income recovers, which presents an opportunity to acquire clinics at depressed multiples with upside to come.

- **Execution:** There is execution risk which involves managing the administrative and marketing functions of acquired practices. Existing back-office experience within management and the Board of Directors will help offset this risk.

- **Lack of Suitable Exits:** The company may need to acquire multiple veterinarian businesses to facilitate an exit at a higher multiple with acceptable returns, as consolidators and corporates tend to like these practices. We will target clinics with expansion potential and bundle multiple veterinarian establishments in a potential sale.

- **Lack of financing:** While management will primarily aim for vender takebacks, payable over a period of years, 100% debt financed roll-ups are commonplace in the veterinarian industry, known for their timely payments.

- **Skilled Labour Shortage:** According to the Ontario Veterinary College, the number of graduating veterinarians remains statistically unchanged for *over a decade*. New entrants will struggle to find qualified labour, bolstering the M&A approach. An acquisitive approach will enable us to purchase clinics with existing veterinarians.

Conclusion

We believe that highly fragmented Canadian veterinarian practices are ripe for consolidation and will benefit from leveraged administrative functions. Increased pet ownership, aging companion animal populations, increased specialization and technological change, and agriculture scrutiny will be major drivers of the industry. We will look for operators with a strong motivation for selling the business. This is a high-conviction industry with plenty of upside.