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MD on Veterinary Pathology Business and Outlook

Open Briefing interview with Greencross Limited Managing Director, Dr Glen Richards

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Greencross Limited (ASX: GXL) is focused on consolidating the fragmented veterinary services industry in Australia. Earnings growth is expected to be generated via improved efficiencies at individual practices and via further active acquisition of established practices.

In this Open Briefing®, MD Dr Glen Richards discusses

- Outlook for veterinary pathology business
- Strategic fit with GXL network and referral base
- Acquisition of two veterinary hospitals

Record of interview:

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Greencross Limited (ASX: GXL) recently announced that it will be the cornerstone investor in a new veterinary pathology business that will be fully operational by 1 September 2012. How does the move into pathology fit with GXL's growth strategy?

MD Glen Richards
We've always taken the view that as we acquire more general veterinary practices, we'd look at allied businesses that would complement our network. Veterinary pathology fits with that long-term strategic view. All our current practices will refer their pathology work to this new business to ensure its success.

We see pathology as a long term strategic fit for expanding our service provision to the veterinary community. Our peer companies, VCA Antec (VCA) in the US and Companion Care (CVS) in the UK, both have veterinary pathology businesses and achieve good revenue and profit margins from them. Up to 86 per cent of work for their pathology businesses is generated from independent veterinary practices. We expect over time a large chunk of work will come from non-Greencross clinics.

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Why did you decide to set up a new pathology business, rather than acquiring an existing business?

MD Glen Richards
We'll install new state of the art haematology and biochemistry facilities, as well as a cutting edge IT platform, at two of our existing practices in Victoria and Queensland. We believe this, along with our solid referrals base from existing Greencross clinics, will allow us to compete more aggressively than if we acquired an already existing business.

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The total set up cost of the two new laboratories is approximately $1.76 million. How will this be funded? What will be the impact on gearing, and will the investment in pathology limit your ability to continue acquiring veterinary practices?

MD Glen Richards
We have an asset financing facility with the Commonwealth Bank of Australian. We'll use some of this as well as free cash to fund the new laboratories. We expect this to have a minimal impact on gearing. The asset facility sits outside the $12 million standby facility we recently announced, so there will be no impact on our ability to acquire veterinary practices.

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The new veterinary pathology business is expected to generate revenue of $4.1 million in FY2014 with EBITDA of $492,000. This implies an EBITDA margin of 12.0 percent compared with 15.6 percent in your existing business in the recent first half. What assumptions underlie this forecast? How amenable is pathology to economies of scale and how might margins trend longer term?

MD Glen Richards
These numbers are based on a slow ramp-up, with business from the Greencross network giving us a good base to the new business. After that, we'll look for new business from independent practices, which will help us grow our pathology margins. VCA has pathology margins of about 30 percent while CVS's runs at about 15 percent in their pathology businesses. Our modelling suggests that longer term, we'll have a margin of approximately 20 percent.

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The estimated size of the Australian veterinary pathology market is approximately $35 million. How will you be positioned in the market and what level of market share do you expect to secure? Will you attempt to consolidate the industry, as you are doing in veterinary services?

MD Glen Richards
We expect to grow the veterinary business, especially our general practices and emergency services, and we think that over the next four to eight years, we'll represent about 10 percent of the Australian veterinary industry revenue. In veterinary pathology, we'll have referrals from our own network, but we'll pick up work from independent operators as well, and expect to take market share of about 30 percent. We don't see the need to consolidate in pathology, but we certainly aim to have our own facilities in the major capital cities in which we operate.

In that sense, our strategy is similar to that of our overseas peers: veterinary pathology is a nice fit with our core network of general practices, which will provide the revenue base for the business.

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Greencross recently agreed to acquire two veterinary hospitals. Total cash consideration for the acquisitions, including deferred payments, is $3.71 million. The acquisitions are expected to deliver annualised revenue of $5.95 million, annualised EBIT of $0.89 million and be EPS accretive in FY2013. What is the strategic rationale for the purchases?

MD Glen Richards
The purchases are hospitals, with bigger formats than the average Australian veterinary practice. They're well within the strategic fit for Greencross practices so we're delighted to have the Woofpurnay Veterinary Hospital in Victoria and South Tamworth Animal Hospital in New South Wales come on board.

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Thank you Glen.

For more information about Greencross, visit www.greencrossvet.com.au or call Glen Richards on (+61 7) 3435 3535

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