CRA Response to CMA Profitability Paper

14th November 2025

1. OVERVIEW

We are disappointed to see that the CMA's base case profitability analysis remains relatively unchanged from its original position, despite the serious concerns put to it in our previous submissions (and those of others), which have not been meaningfully dealt with. However, we welcome the adjustments that the CMA has made to its sensitivities, which are closer to our own view of relevant capital values and replacement costs.

Even on the CMA's own sensitivity assessment, there is no pattern of sustained high profits for CVS. For instance, as set out in more detail in Section 2 below, combining the two key CMA sensitivities (on tangibles and intangibles) already reduces the average ROCE for CVS to [✂]% which is only very marginally above the CMA's WACC range of 7.5-10.5% (and at the bottom end of CVS's actual audited pre-tax WACC, which ranges from [✂]). Further incorporating the CMA's sensitivity on shortened useful economic life results in an even lower average ROCE for CVS of [✂]% - below any reasonable estimate of CVS's average WACC. When we use our own estimates for the value of CVS's intangible assets, in particular, we obtain even lower ROCE estimates.

Although CVS's ROCE was higher during FY2021-2023 than in FY2020 and FY2024, this reflects the very substantial supply/demand imbalance that the entire industry had to respond to in the face of a very swift 50% increase in pet ownership post-Covid.[1] The fact that the market was able to respond so quickly to that surge in demand, bringing CVS's ROCE back down to normal levels in 2024, can be seen as encouraging evidence of a market working well to respond to seismic shifts in the demand landscape, even in the face of staff shortages post-Brexit.[2]

In the rest of this paper we set out our main concerns with the CMA's approach – referring back to our previous submissions where appropriate. In short:

- **Tangible asset valuation:** The CMA's base case dismisses CVS's actual tangibles costs in favour of a proxy based on a sample of other LVGs. It asserts that CVS's own higher fit out costs are likely to result from inefficiency without any evidence to support this assertion, or any rationale for why a publicly traded company would choose to spend inefficiently on fitting out new FOPs. By contrast, the CMA's sensitivity comes much closer to CVS's actual fit out costs, and in our view should become the base case for CVS. We discuss this further in Section 3.
- **Intangible asset valuation:** The CMA continues to use a highly partial and unsubstantiated approach to value intangible assets in its base case, and provides no evidence to support key

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1 Share of households owning a pet in the UK increased from 40% in 2019 and 41% in 2020 to 59% in 2021, 62% in 2022 and 57% in 2023 according to https://www.statista.com/statistics/308235/estimated-pet-ownership-in-the-unitedkingdom-uk/

2 This was achieved largely through incurring additional costs to improve facilities, hire and retain staff, as well as working to remain locally competitive on the increasingly sophisticated medical interventions that many customers want for their pets – although 2024 financial results were also negatively impacted by the Cyber-incident and resulting acceleration of CVS's transition to a new PMS.

assumptions (particularly in relation to the very small degree to which staff costs are capitalised, and the complete lack of capitalisation of other start-up phase costs relating to premises, in particular) – this is discussed in Section 4.1. By contrast, the CMA has made some welcome changes to its "start-up-losses" sensitivity (to take a more economic rather than purely cash-based approach to assessing such losses), which yields a more reasonable estimate of start-up costs. Nonetheless, this still only goes part way to recognising the full value of intangibles as we explain in Section 4.2. As we set out in Section 4.3, the CMA continues to assert incorrectly that our own cost-based approach suffers from circularity, or reflects inefficiencies, and has not addressed (indeed, does not even mention) our previous submissions demonstrating that there is no circularity.

- We also briefly set out in Section 5 how the CMA continues to make assumptions in relation to RDEC, EBIT and WACC that overstate the extent of industry profits.

When we take account of reasonable sensitivities on these points, there is no evidence that CVS made excessive profits at all – and certainly not on a sustained basis, as we show in Section 6. This must be taken into account in judging the likelihood that there is actually any material AEC currently, and therefore also the proportionality of the proposed remedies.

2. EVEN UNDER THE CMA'S OWN SENSITIVITIES, CVS'S ROCE DOES NOT INDICATE A FAILURE OF COMPETITION

The exercise of estimating ROCE is highly dependent on the underlying assumptions, particularly in relation to the total value of capital employed. If the true value of capital employed is not properly captured, the analysis risks ignoring critical assets and finding an excess return on capital when there is none. Further, any such exercise needs to be subject to sensitivity testing to alternative assumptions, as there will inevitably be significant uncertainty over the true value of many of these assets.

The CMA's own sensitivities in fact demonstrate that the CMA's base-case for CVS is not sufficiently robust to conclude that consumers are over-paying due to competition issues in the veterinary services market. The CMA undertakes five sensitivities to complement its "base-case" scenario of LVGs' ROCE analysis, four of which relate to testing their base-case approach to valuing tangible fixed assets, while one relates to their approach to valuing intangibles. Notwithstanding our disagreement with the CMA's base-case methodology, or the limitations of these sensitivities (which we turn to below), it is worth noting that three of these five sensitivities have a material downward impact on the estimated ROCE for CVS.[3] Specifically,

- In sensitivity 'B', the CMA models a "25% increase in fit-out costs" vis-à-vis its base case,[4] which by itself causes CVS's average ROCE over the five-year period to drop to [✂]% from [✂]%.
- In sensitivity 'D', the CMA shortens the expected useful economic life for fit-out costs from its base case assumption of 16 years to 12 years, causing CVS's average ROCE over the five-year period to reduce to [✂]%.

3 See Table 1.4, of Appendix C: Financial and profitability analysis. We address why we do not consider the CMA's two remaining sensitivities to be of value (i.e. Sensitivity A and C) in sections 3.1 and 3.2 respectively.

4 See Paragraph 4.28 of Appendix C: Financial and profitability analysis.

- In sensitivity 'E', the CMA uses a start-up losses approach using an intangible value of [✂] per FOP (as opposed to [✂] of intangibles per CVS FOP based on its base case), causing CVS's average ROCE over the five-year period to reduce to [✂]%.

Each of the three sensitivities, even individually, also show that CVS's ROCE is below WACC at the start of the period in FY2020 (reflecting the immediate impact of Covid restrictions), peaking above WACC only during the major demand shock following Covid (when the number of households with pets increased by 50%), before investments to increase capacity and hire/train more staff (as well as the impact of the cyber incident) brought CVS's returns to levels below WACC in FY2024. In our view, this pattern of profits, even on the CMA's own assessment, cannot be seen as evidence of a lack of competitive pressure on CVS.[5]

It is also odd that the CMA has not presented a sensitivity that combines the above adjustments. Given that the above three sensitivities all relate to different elements of capital employed (i.e. the valuation of fixtures and fittings, the useful economic life and related depreciation charges of fit-outs, and the valuation of intangible assets), the natural next step would have been to check how ROCE evolves under a combination of these adjustments.

The chart below shows the effect of combining these sensitivities on CVS's ROCE. The light teal line shows the CMA's base case while the dashed pink line, the dashed red line and the dashed grey line show CVS's ROCE under sensitivities 'B', 'D' and 'E' respectively. A combination of Sensitivities B (i.e. 25% increase to fit-outs) and E (i.e. start-up loss approach to value intangibles) reduces CVS's ROCE to an average of [✂]% over the five year period, as shown by the dark teal line. Further incorporating Sensitivity E (i.e. using a shortened UEL of 12 years for depreciation) further reduces CVS's ROCE to an average of [✂]% as shown by the dark blue line. Hence, even under the CMA's own sensitivities, CVS's average ROCE across the five-year period ranges between [✂]% and [✂]% which at most, is only marginally above the CMA's WACC range of 7.5-10.5% used to benchmark returns, and below CVS's own average audited WACC.

Therefore, even under the CMA's own assumptions, there is no evidence that CVS made sustained excessive profits over the relevant period, as we would expect to see if there were a serious competition problem in the market. In fact, when looking at a combined view of the sensitivities employed by the CMA, CVS's profits are well below those that might indicate "excessive profits". Temporary returns above WACC caused by an extreme demand shock should only be a cause for concern if competitive pressures do not then bring ROCE back to normal levels reasonably quickly. But this return to normality is precisely what happens in CVS's returns: the market faced a huge challenge of meeting a ~50% surge in pet ownership (and therefore substantially increased demand for veterinary services), in the face of ongoing supply-side constraints stemming from Brexit and Covid. Nonetheless, new investments in sites and staff were made over this period which led to an increase in both operating and capital expenditure, resulting in a reduction of profits back to normal (or below normal) levels by FY2024. CVS's overall profitability was similar in FY2025, with growth stemming from CVS's Australian rather than UK operations.

Figure 1: [✂]

Source: [✂]

5 We do not believe the two sensitivities generating higher ROCE (through a longer UEL and/or lower fit out costs) are at all consistent with the relevant evidence for CVS – for reasons set out later in this document, and therefore do not consider them here.

Table 1 below sets out the corresponding impact of combining the CMA's sensitivities on CVS's estimated economic profits, benchmarked against the CMA's average WACC estimate of 9.0%, the upper bound estimate of 10.5% and the lower bound estimate of 7.5%. Specifically, the CMA's base-case estimate of £108mn in excess profits for CVS is not robust to even the CMA's own view on reasonable alternative assumptions on asset valuation. For instance, combining CMA's sensitivities 'B', 'D' and 'E', we find that the "excess profits" generated by CVS were between [✂], or (using the CMA's WACC range of 7.5 to 10.5%) - or approximately [✂] per year. Even based on the CMA's own assumptions, this cannot arguably be considered evidence of a problem (particularly given that the midpoint of the range is in fact a negative detriment).

Table 1: Estimate of CVS's excess profits under the CMA's sensitivities

	ROCE	Economic profits (WACC = 7.5%)	Economic profits (WACC = 9%)	Economic profits (WACC = 10.5%)
CMA Base Case	[✂]	[✂]	[✂]	[✂]
CMA's sensitivity B: TFA increased by 25%	[✂]	[✂]	[✂]	[✂]
CMA's sensitivity D: Useful life decreased to 12 years	[✂]	[✂]	[✂]	[✂]
CMA's sensitivity E: Using SUL approach for intangibles	[✂]	[✂]	[✂]	[✂]
Sensitivity B (tangibles) + Sensitivity E (intangibles)	[✂]	[✂]	[✂]	[✂]
Sensitivities B, D and E combined	[✂]	[✂]	[✂]	[✂]

Source: [✂]. Note: The ROCE figures presented above differ marginally from the CMA's own estimates in its workbooks by 0.1-0.2 percentage points. The CMA calculates capital employed by averaging the capital base at the close of the current and previous fiscal years. However, when applying adjustments to capital employed (based on tangible or intangible sensitivities), they do not average these in the same way, which we have corrected when presenting our analysis, as noted in our workbook.

In the rest of this paper, we comment on the CMA's updated approach to estimating the true economic value associated with CVS's tangible and intangible asset categories in more detail, including the relevant sensitivities. In each section, we first comment on the changes introduced in the CMA's final profitability paper, discuss why we continue to have concerns with the adjusted approach and then make recommendations for alternative approaches and/or sensitivities that, in our view, would give a more accurate view of CVS's ROCE and WACC (and, implicitly, the competitive pressure CVS faces in the market). As we show in Section 6, if the CMA adopts these sensitivities, it becomes even more clear that there is no evidence of a competition concern in CVS's financial results.

3. THE CMA BASE CASE SIGNIFICANTLY UNDERVALUES CVS'S TANGIBLE ASSET BASE

As previously submitted, we agree broadly with the CMA's general approach to valuing tangibles, i.e. to compute a weighted average replacement cost per square foot and to scale it across the total LVG

estate before applying a reduction to reflect depreciation.[6] Compared to the methodology followed in their Working Paper, CVS is pleased to see that the CMA has now excluded [✂] from the underlying sample of LVG greenfield sites, resulting in a [✂] increase in average fit out costs.[7] CVS also welcomes the CMA's additional sensitivity tests on the useful economic life ("**UEL**") estimate.[8]

However, the CMA continues to use a common fit-out cost per square foot estimated across a sample of LVG sites, when the available evidence clearly shows this would substantially understate CVS's actual fit out costs (and therefore the value of its tangible asset base). The CMA's assertion that CVS's higher costs reflect inefficiency is not borne out by any evidence. The CMA's sensitivity B (of increasing fit out costs by 25%) is much closer to CVS's actual fit-out costs than their base case and, in our view, should be used to compute the tangible value of fixtures and fittings for CVS.

3.1. The CMA continues to rely on a non-representative sample of greenfield sites to estimate the average per square footage figure in its base case

The CMA continues to estimate one common per square footage fit out cost across a sample of LVG sites to estimate the value of CVS's tangibles assets. We previously explained why this methodology is inappropriate and would result in a substantial understatement of actual fit-out costs for LVGs such as CVS who have gone further in updating their portfolio of sites and/or acquiring better quality/more modern sites.[9] CVS's actual fit-out costs per square foot based on the CMA's corrected sample is [✂]% above the average cost estimated across the broader sample.[10]

The CMA justifies its approach by stating that "*it is not clear that these higher fit-out costs reflect greater quality rather than inefficiencies".*[11] However, there is no evidence presented to support the hypothesis that inefficiencies could explain the difference. Rather, the CMA cites a finding that three of the six LVGs earned a higher revenue per square foot than CVS as the reason. However, the underlying calculations are not provided, and there is no indication that the CMA took account of differences in geographic distribution (e.g. proportion of sites in London/South East England), running costs, service mix, etc. in making this comparison.[12] CVS strongly disagrees that its higher fit-out costs reflect inefficiencies rather than an outcome of CVS's continued efforts to provide greater quality of care to pet owners through spacious, improved and modern facilities

Higher fit-out costs in a competitive market are not reflective of inefficiency as long as they are valued by customers. A range of different offerings to the consumer is in fact, positive for competition. As acknowledged by the CMA in their Business Models working paper of 6th February 2025, CVS strives to distinguish itself as a premium brand associated with quality, akin to [✂].[13] Just as it would be

6 For reasons submitted previously, CVS notes that using a total square footage estimate that potentially understates the total area of CVS's estate could result in an estimated gross replacement cost that is conservative. Although CVS does not have access to any better source of data, this should be taken into account in interpreting results.

7 See section 2.1.1 of CRA's previous response on the profitability analysis, submitted on 05th June 2025.

8 See section 2.2 of CRA's previous response on the profitability analysis, submitted on 05th June 2025.

9 See section 2.1.1 of CRA's previous response on the profitability analysis, submitted on 05th June 2025.

10 See Table 3.4 of Appendix C: Financial and profitability analysis.

11 See paragraph 3.69 of Appendix C: Financial and profitability analysis.

12 See paragraph 3.69 of Appendix C: Financial and profitability analysis.

13 See [✂] of the CMA Working Paper of 06 February 2025 on "Business models, provision of veterinary advice and consumer choice (confidentiality ring)".

unreasonable to assume that additional capital spend on fit-outs by [✂] reflect inefficiency (rather than the provision of a better customer experience), it is unreasonable to assume that the higher-fit out costs incurred by CVS reflect an inefficiency rather than a conscious effort to provide a superior quality offering. In fact, CVS has already submitted ample evidence to demonstrate that it is focused on quality improvements across its portfolio of sites, and that the higher quality proposition is commercially rational, as it is valued by its consumers.[14]

In the below table we show the fit-out costs per sq ft based on the CMA's base case approach compared to CVS's corrected approach (i.e. using fit-out costs based on CVS's greenfield FOP openings over the last five years) as well as the CMA's sensitivity of increasing valuations for fit-out costs by 25%.[15] CVS specific fit out costs are higher than the CMA's base-case estimates by ~[✂]% across the five-year period. This means that the CVS specific fit-out costs are very similar to the CMA's Sensitivity B and as such, in our view, this should become the base-case for CVS. The impact of using these figures on the overall profitability assessment is discussed in Section 3.3 below.

For completeness, we note that the CMA undertakes a sensitivity (sensitivity A) to estimate fit-out costs for LVGs using a sample of *independent* clinics. For the same reasons as submitted in CVS's response to the CMA's profitability working paper, CVS does not agree that the CMA's sensitivity of using independent greenfield sites is meaningful. It is possible that the average independent site has a different standard of fit-out compared to CVS. For instance, all CVS practices are required to be PSS compliant and meet a minimum standard of fit out, while independent greenfield sites will encompass a wide range of fit out approaches and decisions on whether to meet PSS standards. As such, lower costs could reflect lower (average) quality rather than any advantage in terms of efficiency or access to lower costs.[16]

Table 2: CVS vs All LVGs - Local clinics fit-out cost per sq ft as at each calendar year end

CMA vs CVS	Average cost per sq ft (£)				
	2020	2021	2022	2023	2024
CMA base case	268	275	299	321	329
(1) Use CMA's estimates of CVS specific cost per sq ft	[✂]	[✂]	[✂]	[✂]	[✂]
% difference	[✂]	[✂]	[✂]	[✂]	[✂]
(2) Use CMA's estimates as per Sensitivity B	335	344	374	401	411

14 In response to CMA's RFI 17 Q31, CVS provided data on post-acquisition investments that shows CVS invested approximately [✂] per site over a five-year period for sites acquired since FY2019. CVS also constantly invests to improve customer net promoter score ("NPS", a metric that evaluates customer perceptions of quality) - see CVS response to RFI17 Q31. Similarly, the CRA response to the CMA's updated econometrics working paper submitted on 23rd May 2025 outlines examples of specific investments and improvements that CVS made post-acquisition while the response to the initial working paper submitted on 28th January 2025 provide examples of quality-related investments aimed at improving quality and customer care. See section 3.1 of CRA's response on the econometrics working paper, submitted on 23rd May 2025 and sections 1.2 & 2.1 of CRA's response on the econometrics working paper, submitted on 28th January 2025.

15 As submitted in Table 2 of section 2.1.1 CVS's previous response to the CMA's profitability working paper, expanding CVS's sample to include greenfield/full refurbishment local clinics opened during the last 10 years for which CVS has reliable fit-out data results in an average fit-out cost per square foot in FY24 that is similar (at [✂] per sq ft).

16 See section 2.1.1 of CRA's previous response on the profitability analysis, submitted on 05th June 2025, for more detail.

Source: [✂]. Note: Based on cost estimates prior to YE adjustments.

3.2. Useful economic life (UEL) of tangible assets

The CMA continues to use an estimated average UEL of 16 years in its base case, but models a UEL of 12 years and 20 years (retaining the 50% discount factor) as part of its sensitivity tests. It is not clear if the choice of these UELs (i.e. the 12 and 20 years) is based on data or if these are arbitrary choices.

As submitted previously, the average UEL based on CVS's standard depreciation approach is generally lower than the CMA's base-case assumption of 16 years. Specifically, CVS estimated that the weighted average UEL across different asset sub-classes (leaseholds, IT equipment, other equipment) for five CVS greenfield openings/refurbishments in the CMA's sample to range from [✂] years to [✂] years.[17] Therefore, whilst the CMA's choice of a UEL sensitivity of 12 years seems sensible based on CVS's data, the CMA's sensitivity C of lengthening the UEL to 20 years , would not reflect the average economic life of CVS's tangible fixed asset categories, and should not be relied on in relation to CVS. For example, based on CVS's experience, medical equipment would not have an economic life of 20 years (with most equipment depreciated over a five-year period).

There are a few other areas where the CMA's analysis may understate the relevant value of tangible assets. Specifically:

- **Freehold properties.** The CMA continues to rely on the NBV of freehold assets based on the reasoning that freehold properties only account for a very small proportion of properties in the LVGs' portfolios and, "[✂]".[18] For the avoidance of doubt, CVS shares the same concerns expressed by other LVGs that a failure to make adjustment to the NBV value of its freehold properties will understate the capital employed (including CVS's) and overstate its profits. Whilst it is true that the data available to CVS indicated a relatively small difference in the NBV of CVS's freehold properties, CVS notes that this difference could be larger for other LVGs. In any case, the CMA does not make *any* adjustment to revalue freehold properties despite the evidence submitted by CVS that shows freehold NBVs being undervalued (albeit only to a relatively small extent for CVS).
- **Vehicles:** The CMA also continues to use the unadjusted accounting value of vehicles under the assumption that "*any adjustment to reflect replacement cost of each LVG's vehicle fleet would not make a material difference to our assessment*."[19] As submitted previously, the overall valuation for vehicles may be slightly understated.

Although we have no means to quantify these impacts, and they are likely to be much smaller (at least for CVS) than the fit-out cost and UEL issues raised above, their existence should be taken into account in interpreting the results of the analysis.

3.3. Impact on profitability assessment

In the below table, we set out the impact of the sensitivities discussed on the CMA's profitability assessment. The CMA's current approach estimates a total fit-out costs of [✂] in FY24 (across FOPs

17 See section 2.2 of CRA's previous response on the profitability analysis, submitted on 05th June 2025.

18 See paragraph 3.20 of Appendix C Financial and Profitability Analysis

19 See paragraph 3.81 of Appendix C Financial and Profitability Analysis

and referrals) or around [✂] per practice.[20] Replacing the CMA's average fit-out costs across all LVGs with CVS specific figures (holding all else constant) increases total capital employed by around [✂]%, and as a result decreases ROCE by at least ~[✂] ppt and as much as ~[✂] ppt across FY20-FY24.

Table 3 : CVS Capital Employed and ROCE under sensitivities on TFA

Sensitivity	Metric	FY20	FY21	FY22	FY23	FY24	FY20-FY24
CMA base case	Capital Employed (£ mn)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	ROCE %	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CVS specific fit-out costs	Capital Employed (£ mn)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	ROCE %	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: [✂]. Note: FY20-FY24 ROCE is calculated as the sum of EBIT across FY20-24 divided by the sum of capital employed across FY20-24. The sensitivity was based on amending the base-case assumptions used in the workbook as shown in our data pack.

4. THE CMA CONTINUES TO SUBSTANTIALLY UNDERVALUE INTANGIBLE ASSETS

In its base-case, the CMA continues to rely on a very limited bottom-up approach that looks at the costs of building a limited set of intangible asset categories during the initial years of operation of a new practice. While the general approach is reasonable in theory (and indeed, we adopt a cost-based approach ourselves), the CMA continues to estimate the value of an incomplete set of intangible fixed asset components, while applying arbitrary assumptions, consequently undervaluing the true replacement costs associated with these assets (and ignoring other aspects of certain intangibles – e.g. central intangibles – entirely). We have submitted a detailed critique of the CMA's base-case approach in our previous response to the CMA's profitability working paper and do not repeat these points below.[21] However, to the extent that the CMA has made some limited changes to its assessment (e.g. to add some costs relating to a single veterinary nurse to those already incorporated for a single vet per FOP), these remain far short of capturing the actual capex required to set up a new FOP.

The partial nature of the CMA's cost assessment becomes clear when comparing the CMA's base-case intangibles estimate with their Sensitivity E that uses "a start-up losses" approach. As shown in the below table, the CMA's base case estimates total intangible assets of [✂] for CVS annually across 2020-2024 whilst their start-up losses estimate intangible assets of [✂] for each FOP, which is ~[✂]% higher than the base case. Moreover, our cost-based approach (as set out our previous response), using a more complete assessment of the costs that need to be invested in order to generate future

20 [✂] (Total fit-out costs) / [✂] (Number of sites in FY24) = [✂].

21 See section 3.2 of CRA's previous response on the profitability analysis, submitted on 05th June 2025.

profits when starting a new FOP, results in average intangibles of [✂] per FOP, which is [✂]% higher than the CMA's base case.[22]

Table 4: CMA intangibles per FOP – CMA base case vs CMA Sensitivity (start up losses)

		FY20	FY21	FY22	FY23	FY24	Average across FY20-24
Number of FOPs for CVS		[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CMA base case	Total intangibles (£ mn)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	Estimated intangible per FOP (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CMA Sensitivity (start-up losses)	Total intangibles (£ mn)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	Estimated intangible per FOP (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CVS cost-based approach	Total intangibles (£ mn)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	Estimated intangible per FOP (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: [✂]. Number of FOPs from RFI 13 Question 1.

In Section 4.1 below, we show that the updated assumptions applied by the CMA in their base-case model are still arbitrary and that they overlook data-based evidence submitted by LVGs including CVS. In Section 4.2 we explain why the CMA's updated "Start Up Losses" approach, although improved, still fails to fully capture the intangible investments required to set up a new FOP. In Section 4.3 we explain why the CMA's criticisms of our own cost-based approach are incorrect, and why this remains in our view a preferable way to capture FOP-level intangibles (although central intangible assets will remain unvalued). In Section 4.4 we explain the impact of these different approaches on the profitability assessment.

4.1. The CMA introduces even more arbitrary assumptions in their updated base-case approach

The CMA essentially apply the same assumptions to estimate intangibles in their base-case approach as used in their working paper with one exception. Specifically, to value the portion of initial employment costs that need to be capitalised (as part of its attempt to value the cost of acquiring customer relationships), the CMA capitalises a portion of one FTE vet's time and one FTE nurse's time (rather than just one FTE vet's time in their working paper).[23]

22 See section 3.1 of CRA's previous response on the profitability analysis, submitted on 05th June 2025.

23 See CMA working paper "Financial and profitability analysis, published on 01 May 2025.

Clearly this remains arbitrary and insufficient: the CMA has received data-based evidence from CVS and another LVG that shows practices typically open with multiple FTE vets, nurses and support staff, as well as more building space than is immediately required to serve the initially small customer list. The CMA appears to have considered this evidence, but CMA compares this with submissions from two independent vets who reported having opened practices with one vet, one nurse and one support staff and concludes, "*In our view, the variation between these numbers is unlikely to be driven by the number of clinical staff devoted to marketing activities and rather by the size of the clinic and the number of vets required to drive expected demand. Moreover, were additional staff required for marketing activities it would appear more efficient (from both a cost and expertise perspective) to employ specialist marketing staff rather than have clinical staff perform this role. In our view this would suggest that it is likely only a proportion of the equivalent of one FTE's time for clinical staff that is spent on marketing activities. We have therefore allocated a portion of one FTE vet's time and one FTE veterinary nurse's time* ".[24]

This reasoning is not logical. In particular, the reality is not that the additional vets and nurses employed by CVS during this start-up phase are engaged explicitly in "marketing" activities for most of their time, but rather that they need to be available to a greater extent than is immediately required to meet the amount of demand present at each point of the ramp-up phase of operations. If new practices did not operate with spare capacity of this type new customers would not receive a good level of service (e.g. would not be able to get an appointment at short notice or to deal with an experienced vet in the event of a complication/emergency), and therefore would not generate the type of positive word of mouth about the "new vet" that is essential to building up a customer base. The need to have this type of spare capacity is a cost that is incurred to build the customer relationship and reputation, and would not need to be incurred if there were no intention to build the customer book beyond its initial size.[25] Some of this spare time can be used explicitly for marketing activities – but the existence of such activities is not the reason for the costs of this "surplus time" to be capitalised.

Therefore employing specialist "marketing" staff would not be an efficient substitute for the availability of a staff of full-time vets and nurses, even before the demand has been developed to fully pay for that time. It is veterinary and front of house support staff that play the most crucial role of building the reputation and customer relationships of a newly established practice, in turn generating future business.

The CMA's approach effectively assumes that a full-scale FOP (with several FTE vets, nurses and support staff) could be established while achieving very high levels of utilisation at a very early stage.

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24 See Paragraph 3.186 of Appendix C: Financial and profitability analysis.

25 Paragraph 3.186. The same misapprehension that staff time must be devoted to "marketing" to be a relevant capital cost associated with setting up the practice is reflected at paragraph 3.185, where the CMA asserts that the fact CVS continues to hire additional vets in years 2 and 3 of operation means that *"by the end of the second year the staff initially recruited to build the clinic have limited excess capacity to devote to growing the practice".* Note also that our approach in any case assumes that by Year 2 the staff hired in Year 1 likely will be fully utilised (as the data shows that staff utilisation increases fairly fast during the early years of operation, and is almost complete by the end of Year 3, while other, less scalable, assets take longer to reach full utilisation). However, the same misunderstanding is reflected here: namely that staff time must be actively used for "marketing" in order to be a relevant part of the cost of setting up a new FOP. This is clearly not the case. If a vet is hired to set up a new practice, and they can only realistically build demand to 50% utilisation in Year 1, the rest of their cost is still a relevant capital cost of setting up the business, even if there is only a small proportion of that time that can be actively attributed to "marketing" activities.

Taking [✂] as an example, which planned to build up to [✂] FTE vets, [✂] FTE nurses and [✂] FTE support staff over [✂] years, the CMA's approach implies that this practice would achieve:[26]

- [✂]% staff utilisation in driving current revenues in Year 1 (applying the CMA's assumption that only 50% of a single vet's and nurse's time would drive future revenues) as the practice employs [✂] Vets, [✂] Nurses and [✂] Support Staff in the first year. This compares to the [✂]% of staff costs that we would view as driving current revenues in Year 1, based on our calculations.
- [✂]% staff utilisation in driving current revenues in Year 2 (applying the CMA's assumption that only 25% of each of a vet's and nurse's time is not invested in driving current revenues) as the practice employs [✂] Vets, [✂] Nurses and [✂] Support Staff in the second year. This compares to the [✂]% of staff costs that we would view as driving current revenues in Year 2.

The assumption that the practice could be built while maintaining such high levels of utilisation even in the first two years of operation – contrary to the actual experience of CVS in setting up greenfield FOPs – is unrealistic and entirely unevidenced.

If the CMA's view is that the additional "spare capacity" that we actually observe in these business plans is attributed to other activities that are not necessary to building future revenues, and do not need to be incurred to build the intangible assets such as reputation associated with an FOP, then it should explain why a rational company focused on providing returns to shareholders would add "unnecessary" staff in this way. In our view the explanation is simpler: having the degree of excess staff capacity seen in CVS's business plans during the first years of operation is simply *necessary* to building a typical sized FOP over a reasonable period of time, in order to build up the type of positive customer experience that is required to drive future demand (through repeat business and word of mouth recommendations to new customers). Therefore these costs are a legitimate capital expenditure on building the intangible asset.

The CMA's cost-based approach also continues to completely ignore other investments that need to be made during the start-up phase (e.g. the fact that it is not efficient to constantly move premises, meaning that a new FOP will start out in a space that is not fully utilised, yet nonetheless has to be fully paid for). The parallel of underutilised space and equipment to underutilised staff costs is clear (whereby the parts of the cost that are not driving current revenues are only incurred because they are necessary to build the mature FOP) – yet for unexplained reasons the CMA continues to take inconsistent approaches to capitalising staff and rent/property costs during the start-up phase in its base case.

The arbitrary nature of these assumptions underscores an inherent shortcoming of the CMA's base-case approach. Largely this is driven by the unnecessary complexity introduced in trying to break down the intangibles of an FOP into different elements of "staff" or "reputation" or "customer list" – distinctions that are largely meaningless. In reality you cannot have a sound reputation and strong customer list without a happy and well-trained set of staff and cannot have a happy and well-trained staff without a good and growing book of customers for them to serve. By ignoring this reality and trying to individually value selected components that make up CVS's intangible asset base, the CMA is forced to rely on arbitrary assumptions that substantially understate the true capital investment required to set up a new FOP.

26 See staged employment over [✂] at [✂] as per Figures 1 and 2 of our previous response to the CMA's profitability working paper dated 04th June 2025. We take [✂] as an example as we used this practice to illustrate how staffing ramps up at a typical FOP.

4.2. The CMA's start up loss approach still understates the costs of setting up a new FOP.

In our previous submission, we outlined several reasons why looking at start-up losses is insufficient to value intangibles.[27] This was particularly the case for the previous version of the CMA's analysis, which only looked at the cash-losses associated with the start-up phase of a new FOP, and therefore entirely ignored the fact that even the first year of profits was likely to fall far short of providing a reasonable return on the capital employed up to that point.

We should first note that the CMA has made some welcome updates to its start-up losses approach, which have increased the value of losses closer to a reasonable estimate of start-up costs.

- First, the CMA has now stepped away from assessing only cash losses and recognises that setting up a new FOP also carries opportunity costs (in terms of capital investments that do not receive a return during the start-up phase). This means that instead of accounting only for cash losses, the CMA now attempts to look at economic costs, taking account of the new FOP's failure to earn a return on capital investments in e.g. facilities leases, equipment, fit out costs, etc.
- Second, the CMA no longer uses an average start-up loss computed across LVG (PAH) and Independent FOPs. As previously stated, the average independent greenfield site is not comparable to the average LVG site, and hence relying on a sample that included independents would significantly understate the intangible asset value of a typical CVS FOP.

Whilst these are welcome changes, a number of weaknesses continue to affect this approach, causing the CMA's updated start-up losses to continue to underestimate the true value of CVS's intangible capital base. We already set these out in previous submissions, but to summarise:[28]

- The CMA's approach remains subject to a circularity risk. In particular, because most of the examples it relies on are practices that were set up in recent years, and because it relies on actual costs and revenues, it may overstate the extent to which practices can break even (as the revenues earned and speed to maturity will reflect the unprecedented increase in pet ownership post-Covid). As such, it may well understate the actual cost of setting up a new FOP under more normal market conditions.
- The CMA's approach will also undervalue intangibles if tangible assets and/or WACC are undervalued (as it will then understate the cost of maintaining that capital during the start-up phase). In our view, as set out in Section 3 above and in our previous submissions in relation to WACC, these values remain understated.
- The CMA's approach remains sensitive to arbitrary choices made over the granularity of the data (e.g. using a monthly rather than annual approach would increase the loss-making period, giving a higher estimate of start-up losses on precisely the same facts), and will be sensitive to the point during the financial year at which the FOP was opened.
- Finally, the CMA's start-up losses approach relies on a sample of PAH greenfield sites. As such, it is not clear that the sample of PAH sites in the CMA's sample are comparable to CVS's greenfield sites. There are differences in PAH's business model that could affect how start-up costs and losses evolve for these sites. Without having access to or fully understanding PAH's business plans for

27 See section 3.3 of CRA's previous response on the profitability analysis, submitted on 05th June 2025.

28 See section 3.3 of CRA's previous response on the profitability analysis, submitted on 05th June 2025.

these sample of sites, we cannot meaningfully comment on the CMA's adjustments to the proposed vet salaries or the amortisation charges for these sample of greenfield openings.

Therefore, while the CMA's updated start-up losses approach does take important steps towards incorporating relevant set-up costs into its analysis, it remains incomplete, and in several respects arbitrary, and continues to understate the true intangible value created when CVS sets up a new FOP.

4.3. Our proposed cost-based approach is simple, coherent, and not circular

The issues outlined above can be overcome by a more complete cost-based approach, as we have set out in our previous submissions. Despite our prior submissions demonstrating clearly that our approach is not circular and would not be affected by the presence of any market power during the start-up phase, the CMA continues to assert it is circular without evidence or reasoning.[29] We therefore refer the CMA back to Section 3.1.1 of our response dated 5th June 2025, where we provided a worked example showing that the intangible asset value we calculate is the same even if we artificially inflate revenues and keep all other inputs the same. The CMA's updated profitability paper has not responded to this analysis at all, but instead focusses on dismissing the "lost profits" approach proposed by some other LVGs (which we discussed only in the alternative, and not as our primary proposal for valuing intangibles) – this is not (as we have already submitted) our proposed or preferred approach.

The PDR unfortunately provides no reasoning why our actually proposed cost-based approach should not be preferred, given it is both simpler and more coherent than either of the CMA's proposed approaches. To summarise our continued position, our proposed approach is:

- Simpler because it does not require the intangible to be artificially broken down into multiple sub-categories of assets (e.g. staff versus customer relationships) that, in reality, are inextricably interlinked, and
- More coherent, because it looks at the overall costs of setting up a new FOP, and as such avoids missing relevant elements of the FOP-level intangible, or double-counting elements. Unlike the CMA's sensitivity, it is also not sensitive to the use of monthly versus annual accounting, or being unduly influenced (either upwards or downwards) by the immediate impact of Covid and then the substantial demand/supply imbalance seen during the post-Covid boom in pet ownership.

As submitted previously, our approach is purely based on forecast costs and is not sensitive to how profitable the FOP is (e.g. the same FOP would be ascribed the same intangible value, regardless of whether revenues were doubled or halved from the starting value, as we only capitalise a proportion of costs). In our proposed cost-based approach, revenues are only used to get a sense of how close a business is to its steady-state size in terms of activity levels, and therefore how much of the cost is required to generate current revenue, and how much is only incurred to meet future revenues. Instead of using revenues as a scaling factor, this could in principle be done instead through a volume metric (e.g. number of appointments), but unfortunately volumes of this type are not tracked in CVS's standard business plans – whereas revenues are. However, this does not cause the normal "circularity" concern associated with some revenue-based measures, because we are only using a *ratio* of revenues, and not absolute revenue levels. To the extent that revenues were inflated due to any failure of competition, this would be just as much be the case for Year 1 revenues as Year 5 revenues – and therefore we would expect the ratio between these two values to be a good proxy for the volume growth of the FOP, even if there were some degree of supra-competitive pricing in the market. Our approach is therefore

29 See section 3.1 of CRA's previous response on the profitability analysis, submitted on 05th June 2025.

not subject to the circularity problems of an "opportunity cost" approach – this was explicitly demonstrated using a thought experiment in section 3.1.3 of our previous response as promised during a meeting with the CMA on 21 May 2025.

The CMA does suggest at paragraph 3.184 that part of the costs we capitalise could be driven not by required investments to set up an FOP, but rather by either "normal fluctuations in revenue" or "inefficiencies".[30] In our view these concerns also do not hold:

- Our analysis is based on business plans, rather than actual outturns, and therefore (unlike the CMA's start-up losses analysis) will not be impacted by one off shocks to the market (e.g. due to the increase in demand and costs associated with Covid), or by errors that may be made in setting up any particular practice (e.g. making a poor choice of senior vet to lead the practice, which could reduce revenues/delay time to maturity). This is precisely the reason we chose to base our analysis on business plans rather than outturn data (which could be "noisy" in this way).
- CVS has no incentive to plan for inefficiency, and indeed has strong commercial incentives not to be inefficient in the costs of setting up a practice. Costs unnecessarily incurred in setting up a practice mean lower profits for shareholders. The CMA has provided no reasoning why it believes that such inefficiencies would be built into CVS's business planning assumptions, on which our calculations are based.

In the below section, we show the impact of using our proposed cost-based approach on CVS's estimated ROCE. Of course, even our approach is not complete (in particular, it does not account for central intangibles associated with CVS's veterinary and organisational know-how) – but we consider that can be taken into account by allowing for a reasonable gap between ROCE and WACC before a lack of effective competition is suspected.

4.4. Impact on profitability assessment

The table below compares the impact of the CMA's base-case approach, Sensitivity E approach and our proposed cost-based approach to intangible asset valuation on CVS's capital employed and ROCE. Using our start-up costs approach increases CVS's estimated capital employed, bringing its ROCE to an average of [✂]% across the five-year period (all else equal). The CMA's start-up losses approach yields an intangible value for CVS's assets which is much closer to our "cost-based approach", compared to the CMA's base case approach – but still in our view undervalues intangibles and therefore overstates ROCE.

Table 5: Our start-up costs based approach – Impact on profitability assessment

Sensitivity	Metric	FY20	FY21	FY22	FY23	FY24	FY20-FY24
CMA base-case	Capital Employed (£ mn)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	ROCE %	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CMA sensitivity E (start-up loss)	Capital Employed (£ mn)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	ROCE %	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

30 See Paragraph 3.184 of Appendix C: Financial and profitability analysis

Sensitivity	Metric	FY20	FY21	FY22	FY23	FY24	FY20-FY24
CVS start-up costs approach	Capital Employed (£ mn)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	ROCE %	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: [✂]. The sensitivities are based on amending the base-case assumptions used in the workbook as shown in our data pack using CVS's data on greenfield sites.

5. THE CMA'S APPROACH TO RDEC, EBIT AND WACC REMAINS FLAWED

In our previous paper, we explained why we disagree with the CMA's approach to RDEC, estimating EBIT and to WACC. The CMA continues to adopt the same approach to estimate these items, and we continue to view this approach as overstating profitability. In brief:

- **RDEC:** Including RDEC within EBIT is conceptually inconsistent and economically misleading. The credit is not earned from customers or market activity but represents a government rebate to incentivise R&D in the veterinary sector. Treating it as income overstates operational profitability and implicitly assumes that removing the scheme would enhance competition or benefit consumers, which is clearly incorrect (and the CMA has not explained why this should be the case, in its view).
- **Acquisition costs:** The CMA excludes expenses relating to the acquisition and disposal of vet practices from its calculation of EBIT. As set out in section 4.2 of our previous response, while we can see the logic in excluding the one-off costs associated with the divestment of Quality Pet Care Ltd. in FY2023 (which is not directly relevant to building or running the CVS business as it exists today), we do not agree with the exclusion of other standard costs associated with acquiring new practices given these acquisitions are largely how CVS (and most other LVGs) have built its business, justifying its investment in the wide range of services and central-office infrastructure that all CVS practices are able to benefit from.
- **WACC:** The CMA now uses a pre-tax WACC range of 7.5% to 10.5% when assessing the profitability of LVGs (rather than only a point estimate). Whilst this partly goes towards addressing the fluctuations in WACC over the relevant time period, as submitted in Section 5.2 of our previous response, in our view, each firm's performance should be assessed in relation to its own WACC given this is a market where there are different successful business models, with different implications for the cost of capital (among other costs). In the case of CVS, its own audited pre-tax WACC averages [✂]% (ranging from [✂]% to [✂]% during the five year period) - higher than the CMA's current range which it uses to benchmark returns.[31]

31 See Table 23 of CRA's previous response on the profitability analysis, submitted on 05th June 2025

6. OVERVIEW OF SENSITIVITY ANALYSIS

The below table shows the impact of the various corrections discussed above on the CMA's profitability assessment for CVS. Both under the CMA's own sensitivities as well as CVS's proposed adjustments, we find that there is no pattern of sustained higher profits.

It can be seen that once we take account of all the adjustments discussed above, CVS's ROCE is only ~[✂]% in FY2020 (reflecting Covid closures and costs) and FY2024 (reflecting CVS's cyber-incident, costs associated with hiring and retaining staff following Covid and the costs and pressures of the ongoing CMA investigation) with a more normal ROCE averaging ~[✂]% between FY2021 and FY2023 predominantly reflecting a period when firms struggled to meet the spike in demand resulting from increased pet ownership and catch-up care following the initial Covid period restrictions.

Table 6: Overview of impact of sensitivities on CVS profitability assessment (ROCE)

Sensitivity	FY20	FY21	FY22	FY23	FY24	FY20-FY24
CMA base case	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CMA sensitivities B + E	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CMA sensitivities B + E + D	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CVS sensitivities (from the CMA base case)						
Start-up cost approach (base-case)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CVS-specific fit-out costs	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
RDEC excluded	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CVS combined sensitivities	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CVS Pre-tax WACC	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: [✂]. The sensitivities are based on amending the base-case assumptions used in the workbook as shown in our data pack.

As can be seen from the table, using a reasonable range of sensitivities we see no clear evidence that CVS's average ROCE over the 5 year period in question exceeded its cost of capital. Indeed this is the case even when combining the CMA's own key sensitivities, even before further reasonable adjustments to those assumptions are made. This is despite the fact that the market experienced a very substantial demand shock during the relevant period, which unsurprisingly increased returns temporarily, resulting (as we would hope to be the case in a well-functioning market) in investments in staff retention and facilities that in turn led to a decline of ROCE back to normal levels. This pattern is in our view rather encouraging on the ability of the market to respond to market signals to invest in additional capacity when required, rather than a cause for concern.