

SPIKE IN PET OWNERSHIP FUELS M&A ACTIVITY ACROSS KEY SEGMENTS

PET SECTOR UPDATE | JULY 2023



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PARTNERS**

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Pet Sector

Spike in Pet Ownership Fuels M&A Activity Across Key Segments

KEY SECTOR TAKEAWAYS

Capstone Partners' [Consumer Investment Banking Group](#) is pleased to share its Pet Sector report. Participants in the Pet sector have continued to benefit from pandemic-related upticks in pet ownership. Capstone expects merger and acquisition (M&A) activity to remain healthy as both strategic and PE-backed buyers continue to execute on their inorganic growth plans in the Pet sector. Several key takeaways are outlined below.

1. In addition to the surge in pet ownership during the pandemic, sector strength has been fueled by consumers increasing total spending on their pets, including seeking services and higher-quality products.
2. E-commerce retailers have reported record revenues, as consumers have shifted to online buying with home delivery for convenience and product variety.
3. Trends toward freeze dried, raw, healthy, and even human-grade pet food have increased product development, with new premium pet food brands redefining the segment.
4. Consolidation among veterinary services providers and animal hospitals continues to drive M&A volume.
5. Strategic buyers in the sector are well-positioned to execute tuck-in acquisitions to build out product line depth.
6. Private equity-backed platforms in the Pet space continue to grow through add-on acquisitions. Notably, Primal Pet Foods (backed by Kinderhook Industries), Antelope (Alpine Investors), and BrightPet Nutrition Group (A&M Capital Partners) have all made multiple acquisitions.
7. As predicted last year, we have seen new entrants into the Pet space, with active acquirers including both publicly-held consumer packaged goods (CPG) firms and private equity groups.

Capstone Partners has developed a full suite of corporate finance solutions, including M&A advisory, debt advisory, financial advisory, and equity capital financing.

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POST-COVID PET SPENDING ACCELERATES SECTOR GROWTH

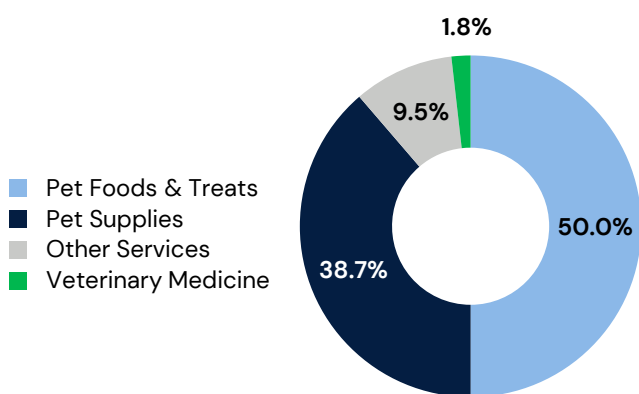
Increased pet ownership during the COVID-19 pandemic among Millennials and Gen X has resulted in substantial growth in the Pet sector. As of 2022, 70% of U.S. households owned a pet, up from 67% in 2021, according to the American Pet Products Association (APPA).¹ Additionally, from the start of the pandemic, 14% of current or non-pet owners have added a new pet to their household.

Consumer prices for pet products rose 9% year-over-year (YOY) through June, with pet food specifically rising 12.1% during the period, according to the U.S. Bureau of Labor Statistics.² At the same time, U.S. spending on the Pet sector has continued to climb each year, and expenditures rose 10.7% from 2021 to 2022 to reach \$136.8 billion, according to the APPA.³ Spending growth in the category is expected to fuel M&A activity as strategic and private equity acquirers compete to purchase high-growth, recession-resistant assets with loyal customer bases.

E-commerce retailers have been uniquely positioned to benefit from the favorable tailwinds in the Pet sector. Notably, Chewy (NYSE:CHWY), one of the largest pet-focused e-commerce retailers in the U.S., reported sales of \$10.1 billion in its fiscal year 2022, an increase of 13.6% YOY, according to the company’s earnings release.⁴ Chewy’s strong financial performance followed a period of rapid interest rate hikes and uncertain economic conditions. Despite macroeconomic challenges, many Pet sector participants have maintained healthy revenues and profit margins. Additionally, sector players with active acquisition strategies have pursued high-quality assets with strong growth prospects to increase capabilities and production volume. For example, the acquisition of Bravo Pet Foods added needed freeze-drying capacity for BrightPet Nutrition Group (October 2022, undisclosed). Similarly, the acquisition of Red Collar’s manufacturing assets provided Colgate-Palmolive’s (NYSE:CL) Hill’s Science Diet and Prescription Diet brand with the increased production capacity it needed to keep up with demand (August 2022, \$700 million).

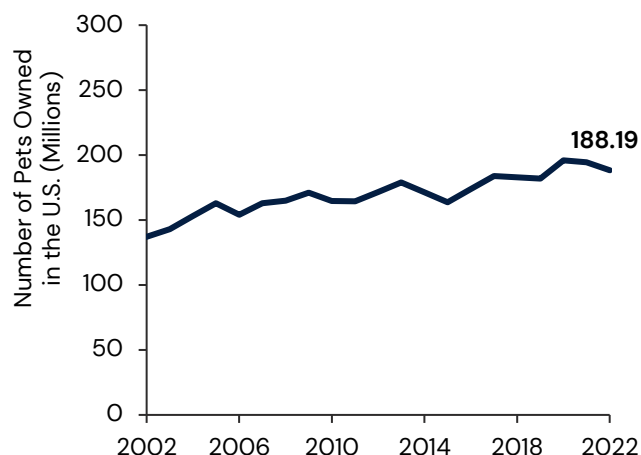
Consumer demand for high quality pet offerings is expected to fuel product innovation, expanding smaller segments and creating new product categories. For example, the Pet Supplements segment, which has been regarded as a niche segment for wealthy pet owners, has demonstrated rapid growth. The Pet Supplements market was valued at \$2 billion in 2022 and is forecasted to grow at a compounded annual growth rate (CAGR) of 5.9% from 2023 to 2030, according to Grand View Research.⁵ In addition, pet technology firms have remained active sector participants, racing to introduce new products. For example, PETKIT has focused on developing cutting-edge products such as wearable cameras and self-changing litter boxes that combine technology with day-to-day pet needs.

Pet Food & Treats Comprise Largest Share of Online Pet Products Sales



Source: IBISWorld

Dog and Cat Ownership in the U.S. Continues to Increase



Source: The American Veterinary Medical Association

PET FOOD SEGMENT REBOUNDS

Food Segment Resilience Tested

A rapid rise in both input costs and transportation cut into profits of pet food manufacturers. The ability to raise prices has dictated if manufacturers have been able to maintain profit margins. As the cost of raw materials and transportation has decreased, manufacturers have fought to maintain elevated pricing levels, which will lead to a welcomed return to increased profitability.

Humanization Drives Premium Pet Food Brands

Pets, especially dogs and cats, have become increasingly humanized. As a result, owners have become more selective about the food their companions eat. Many consumers have opted to feed their pets premium foods, made from sustainable and human-safe ingredients. As a result, top pet food manufacturers have changed branding and product offerings to conform to consumer preferences. High-end dog foods like Ultimate Pet Nutrition's Nutra Complete—which is veterinarian developed and contains beef, seeds, fruits, vegetables, and vitamins—can cost up to \$60 dollars a pound, according to the company's website.⁶ These new brands have not only set the benchmark for acceptable pricing in the segment, but, have also raised pet owners' expectations for quality pet foods.

The acquisition of Natures Logic by Mid America Pet Food, backed by private equity firm TA Associates, (August 2021, undisclosed) and Beach Point Capital's acquisition of Wet Noses (April 2023, undisclosed) are two examples of private equity firms investing in established premium pet food brands to enter the growing Premium segment. Wet Noses uses 100% human-grade ingredients and markets its products to younger pet owners through engaging packaging and a robust product mix. Private equity firms looking to enter the market have been attracted to manufacturers with innovative product offerings and their young, loyal customer bases.

Pet Food Costs Rise at Faster Rate than Price of Pets, Supplies, and Accessories

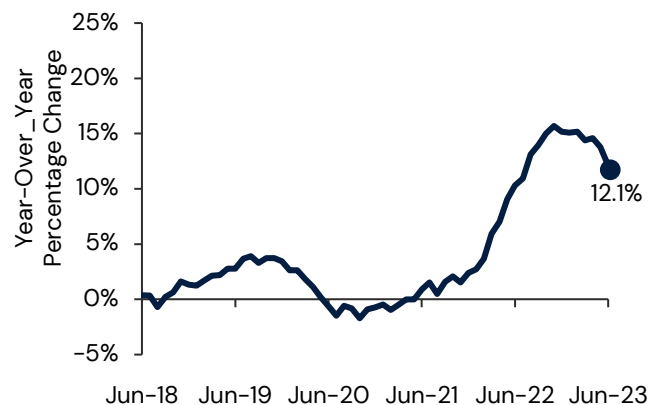
The price of pets, pet supplies, and accessories has risen 4.2% YOY in June compared to a 12.1% rise in pet food, according to the U.S. Bureau of Labor Statistics. Costs have shown signs of



Tom Elliott,
Managing Director

"The increasing imbalance between the supply and demand of contract manufacturing for pet food has spurred some recent M&A activity. The acquisition of Red Collar manufacturing assets by Hill's to support the strong growth of its Science Diet Brand and the merger of Natural Balance with Canidae are two prime examples of transactions motivated by access to manufacturing. Discussions with buyers in the space have indicated that numerous deals are under LOI and I expect a flurry of pet deals closing in Q3 and into Q4."

Pet Food Demonstrates Signs of Disinflation
(U.S. City Average Price)



Source: U.S. Bureau of Labor Statistics

disinflation, with price increases receding from their peak in November 2022, when YOY prices rose 15.7%. While essentials such as food are a mainstay for pet owners despite inflation, there has been a reduction in the sale of discretionary items. For instance, pet toy purchases declined 16% YOY as of February 2023 and pet housing sales were down 21% during the same period, according to the *Wall Street Journal*.⁷ Pricing power will remain paramount for hard goods providers through 2023 as consumers grapple with an elevated cost environment.

CONSOLIDATION IN PET SERVICES BEGINS TO RAMP UP

Spending on Services

Current macroeconomic trends have undoubtedly impacted consumer purchasing behaviors, yet disposable income has increased 8.0% YOY in May, according to the Bureau of Economic Analysis.⁸ Rising disposable income is expected to support pet services spending with the average cost for dog grooming services ranging between \$30 and \$90, according to Daily Paws.⁹ Along with the ability to charge high prices, an increased interest in quality pet services has caused an explosion of pet grooming and boarding businesses, with total establishments standing at 153,780 in 2022, up by 6.2% from 2021, according to an IBISWorld report.¹⁰

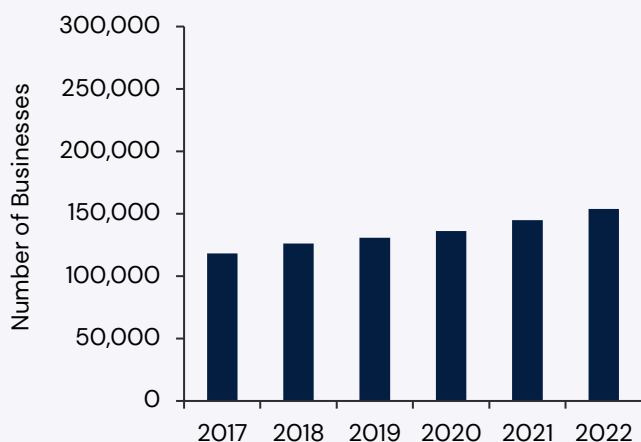
As many pet owners have returned to in-person work and travel, third-party pet care services have rebounded from their COVID-19 slump. The Pet Grooming & Boarding segment has rallied from a pandemic revenue loss of 12.6% to revenue gains of 6.4% in 2022, according to the IBISWorld report. Trivest Partners' and Queens Court Capital Management's platform investment in Pet Resort Hospitality Group (PRHG) in April has indicated that some private equity firms are willing to pursue a roll up strategy despite a lack of targets with scale. PRHG will utilize a buy-and-build strategy to offer daycare, boarding, grooming, and training across various states.

Vet Services Consolidation Continues

Due to the rise in pet ownership, the Veterinary Services segment is projected to grow at a CAGR of 6.7% from 2022 to 2030, according to Global Market Insights.¹¹ Veterinary services represent the greatest cost to pet owners, with annual veterinary spending for dogs and cats amounting to \$700 and \$379, respectively, according to the (APPA) 2021 -2022 National Pet Owners Survey.¹²

Veterinary Services has been the most active M&A segment in the Pet sector, with 12 deals announced closed YTD, comprising 24% of M&A volume. Private equity firms have also entered the Veterinary Services sector to capitalize on secular trends. One example is Veterinary Practice Partners (VPP), backed by Audax Private Equity. Based in Pennsylvania, VPP has more than 125 animal hospitals throughout the U.S. and has made two acquisitions to date in 2023. In February, VPP acquired Olde Towne Animal Hospital based in Southampton, New York. Terms of the deal were undisclosed. VPP subsequently acquired Caring Hands Animal Hospital, which operates eight veterinary hospitals in Maryland and Virginia (April 2023, undisclosed).

Number of Pet Boarding and Grooming Businesses on the Rise



Source: IBISWorld

Veterinary Services Revenue Remains Robust Despite Economic Headwinds



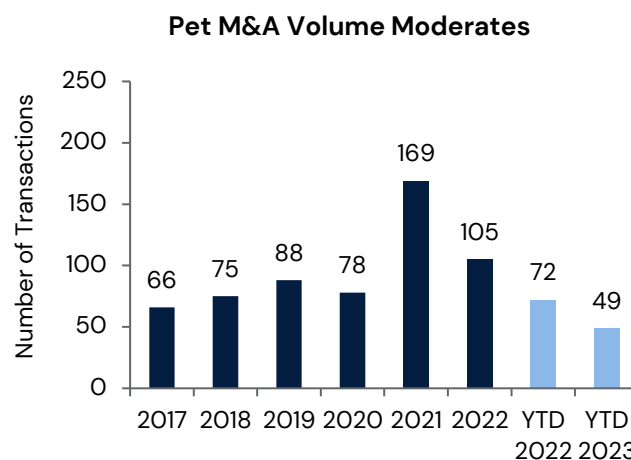
Source: U.S. Census Bureau

CPG COMPANIES PURSUE PET SEGMENT

M&A volume in the Pet sector has moderated in 2023, with 49 total transactions announced or completed through July 19. While M&A volume has receded from 2022, activity is outpacing pre-pandemic levels, with average YTD volume for 2017–2019 standing at 40 transactions. Rising interest rates have likely moderated private equity appetite, and as a result, strategic buyers have significantly increased their share of transactions from 56.2% in 2022 to 63.3% in YTD 2023.

Major CPG (consumer packaged goods) companies like Nestle (SWX:NESN), Mars, and Clorox (NYSE:CLX) have led the pursuit of the Pet sector. In February, Post Holdings (NYSE:POST) announced the acquisition of J.M. Smucker’s Pet Food business, which includes brands such as Nature’s Prime and Kibbles ‘n Bits, for an enterprise value of \$1.2 billion or 0.9x revenue. In recent years, large sector players have also demonstrated a keen interest in pet products providers with robust ecommerce capabilities. Notably, Mars acquired direct-to-consumer (DTC) petfood brand Nom Nom for \$1 billion (January 2022), according to Bloomberg.¹³ This adds to Mars’ Petcare division of online enabled brands, having acquired Pretty Litter (September 2021) for an enterprise value between \$500 and \$1 billion, according to Bloomberg.¹⁴ Strategics have demonstrated a willingness to pay significant premiums to add quality DTC pet food brands with extensive product lines and loyal customer bases.

Capstone expects M&A volume to remain healthy in the second half of 2023. Strategic and private equity buyers will likely look to be aggressive in their acquisition strategies, acquiring firms that are well-positioned to take advantage of long-term sector growth prospects.



Year-to-date (YTD) ended July 19
Source: Capital IQ, FactSet, PitchBook, and Capstone Partners

Pet Valuation Analysis

Valuation Method	Average Revenue Multiple	Average EBITDA Multiple
Historic M&A Transactions (2020–YTD)	3.1x	15.1x
Public Company Trading Multiples (LTM)	2.4x	14.0x

Year-to-date (YTD) ended July 19
Source: Capital IQ, FactSet, PitchBook, and Capstone Partners

Valuation Insight

M&A transaction multiples in the sector have averaged 15.1x EBITDA from 2020 through 2023 YTD, with large retail chains, veterinary services companies, and food manufacturing brands commanding the highest multiples. Historic EBITDA multiples have been buoyed by consolidation among public companies in the sector. Notably, Dechra Pharmaceuticals (LSE:DPH), a market leader in a wide variety of pet products, acquired Med-Pharmex, a producer of generic human and veterinary drugs, in August 2022 for an enterprise value of \$260 million, equivalent to 6.1x revenue and 17.0x of EBITDA. Elevated valuations in the Pet sector are indicative of buyers’ willingness to pay premium multiples for sector participants with strong margin profiles.

STRATEGIC BUYERS REMAIN ACTIVE ACROSS SEGMENTS



Tom Elliott,
Managing Director

"We continue to see very high levels of buyer interest on active mandates as well as inbound interest from buyers looking for acquisition opportunities in the pet and vet spaces. We have also experienced an uptick in interest from international buyers which we expect will help keep valuation multiples solidly in the double digits."



Kennel Connection, a leading developer of boarding, daycare, and grooming software solutions, acquired PawLoyalty Software (March 2023, undisclosed). The two firms are well-aligned in service offerings, allowing for a seamless integration of PawLoyalty's features and applications into Kennel Connection's platform. The acquisition unifies two of the largest dog kennel and daycare software providers in the sector, strengthening both companies' market positioning amid a flood of private equity interest and activity.

Nexus Capital-backed Natural Balance Pet Foods acquired sustainable pet food manufacturer Canidae Pet Food in March (financial terms not disclosed). The acquisition brings together two established brands focused on healthy, innovative offerings and strengthens Natural Balance's product portfolio with the additions of Canidae's Pure, Goodness, and All Life Stages offerings. Private equity firm L Catterton, previously the majority shareholder of Canidae, will also stay invested in the new entity and has contributed growth capital to support its strategic expansion.



PetIQ (Nasdaq:PETQ) acquired Rocco & Roxie Supply for an enterprise value of \$26.5 million, equivalent to 0.9x revenue (February). The acquisition will add to an already extensive list of animal care brands owned by PetIQ, adding cleaning, training, and treat products. "We expect to significantly increase Rocco & Roxie's points of distribution and expand pet product offerings over the next few years. Looking forward, we believe we are well positioned for solid growth in 2023 across our Product and Services segments to attract more pet parents to our health and wellness offerings," said Cord Christensen, Chairman & CEO of PetIQ, in a press release.¹⁵

Antech, a leading veterinary care and diagnostics provider, announced the acquisition of Heska (Nasdaq:HSKA) in February, for an enterprise value of \$1.4 billion or 5.6x revenue. Antech operates as a subsidiary of MARS. The acquisition represents a per share price of \$120, a 23% premium over the unaffected stock price on March 31, according to the press release.¹⁶ Heska specializes in the production of diagnostics tools and treatments for the Veterinary segment. The acquisitions expands Antech's service offerings while allowing for key synergies to be realized.

SELECT TRANSACTIONS: PET RETAIL/SERVICES

Date	Target	Acquirer	Target Business Description	Enterprise Value (mm)	EV / LTM	
					Revenue	EBITDA
04/03/23	Feeders Supply Company	Houchens Industries	Owens a pet food and supply store.	-	-	-
03/23/23	Seven Kriser's Natural Pet stores	Nkomo	Operates seven Kriser's Natural Pet stores in California.	-	-	-
03/13/23	Six Loyal Biscuit pet supply stores	Nkomo	Operates six Loyal Biscuit pet supply stores.	-	-	-
03/13/23	Loyal Biscuit	NPM Franchising	Retails pet food.	-	-	-
03/02/23	20 Loyal Companion Pet Stores	Pet Supplies Plus	Operates pet stores.	-	-	-
03/01/23	Bsm Partners	Finn Cady Brand	Operates as a pet care research, consulting, and strategy-to-shelf product innovation firm.	-	-	-
02/24/23	Pawprints of Vero Beach	Destination Pet	Offers pet care services, including boarding, grooming, training, and day care services.	-	-	-
02/24/23	Pet Specialties	Feeder's Supply	Operates a pet supply store.	-	-	-
02/01/23	PawLoyalty Software	Software Connection	Provides a feature-rich business management software for kennels, dog groomers, and dog daycares.	-	-	-
01/03/23	Dog Food Advisor	Wag! Group (Nasdaq:PET)	Provides pet food reviews and ratings.	\$9.0	-	-

SELECT TRANSACTIONS: PET PRODUCTS

Date	Target	Acquirer	Target Business Description	Enterprise Value (mm)	EV / LTM	
					Revenue	EBITDA
03/16/23	Muffin's Blind Dog Clubhouse	Paw Acquisition	Designs and distributes dog products.	-	-	-
03/06/23	Wildpaw	Pet Wellness	Produces and retails hemp-based supplements and multi-vitamin nutrition products for dogs.	-	-	-
02/28/23	Rocco & Roxie Supply	PetIQ (Nasdaq:PETQ)	Manufactures and sells grooming and spa products including shampoo and fashion accessories.	\$26.5	0.9x	-

Source: Capital IQ, PitchBook, FactSet, and Capstone Partners

SELECT TRANSACTIONS: PET CONSUMABLES

Date	Target	Acquirer	Target Business Description	Enterprise Value (mm)	EV / LTM	
					Revenue	EBITDA
03/21/23	CANIDAE	Natural Balance Pet Foods	Produces and sells pet food.	-	-	-
02/16/23	Wet Noses	Beach Point Capital Management	Manufactures and sells dog and cat food, treats, and food toppers.	-	-	-
02/08/23	Ainsworth Pet Nutrition	Post Holdings (NYSE:POST)	Comprises assets related to pet food business.	\$1,209.1	0.9x	-
02/07/23	Red Collar Pet Foods	Nestlé Purina PetCare	Manufactures pet treats.	-	-	-
11/01/22	Bridge Agri Partners	The Andersons (Nasdaq:ANDE)	Provides ingredients to the Pet Food segment.	\$14.6	-	-
11/01/22	Champion Petfoods	Mars Petcare	Produces and markets pet food products for dogs and cats.	-	-	-
10/18/22	Animix	Benford Capital Partners	Produces vitamin and mineral mixes, feed additives, and biotechnology products.	-	-	-
08/16/22	Puppy Gang Fresh Foods	LiveFit North America	Comprises a pet food production facility.	-	-	-
06/30/22	The F. L. Emmert	Wilbur-Ellis Nutrition	Provides quality animal feed ingredients with exceptional value and service.	-	-	-
01/25/23	Treat Planet	Inverness Graham Investments	Offers natural, healthy, and environmentally-friendly dog products.	-	-	-

SELECT TRANSACTIONS: VET & HEALTH

Date	Target	Acquirer	Target Business Description	Enterprise Value (mm)	EV / LTM	
					Revenue	EBITDA
04/06/23	Caring Hands Animal Hospital	Veterinary Practice Partners	Operates a chain of veterinary hospitals.	-	-	-
04/06/23	Avanti Equine Veterinary Partners	Altano Gruppe	Provides equine veterinary care services.	-	-	-
03/01/23	Glamorgan Animal Clinic	VCA Canada Animal Hospitals	Operates an animal clinic providing medical and nutrition consultations.	-	-	-
02/28/23	Heska Corporation (Nasdaq:HSKA)	Antech	Manufactures and sells diagnostic and specialty products and solutions for veterinary practitioners.	\$1,374.5	5.6x	-
02/02/23	Olde Towne Animal Hospital	Veterinary Practice Partners	Operates as a veterinary hospital.	-	-	-
01/30/23	Merimbula Veterinary Clinic	Apiam Animal Health (ASX:AHX)	Operates as a veterinary clinic.	-	-	-
01/17/23	PetCareRx	PetMed Express (Nasdaq:PETS)	Provides pet medications, accessories, toys, treats, and supplies in the U.S.	-	-	-

Source: Capital IQ, PitchBook, FactSet, and Capstone Partners

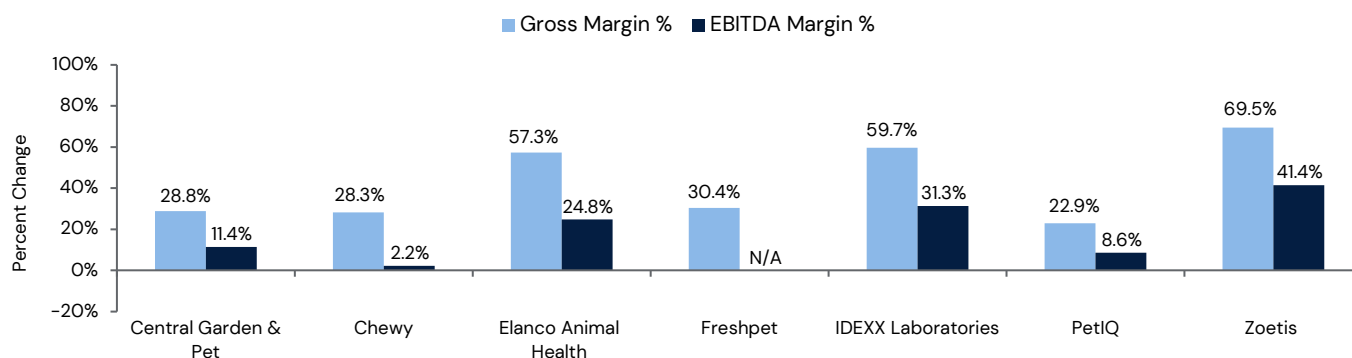
PUBLIC COMPANY DATA

Company	Price 07/19/23	% 52 Wk High	Market Cap	Enterprise Value	LTM			EV / LTM	
					Revenue	EBITDA	Margin	Revenue	EBITDA
Central Garden & Pet Company	\$40.12	87.4%	\$2,082.0	\$3,419.6	\$3,259.5	\$370.2	11.4%	1.0x	9.2x
Chewy, Inc.	\$38.07	72.0%	\$16,272.2	\$15,997.4	\$10,455.3	\$226.8	2.2%	1.5x	NM
Elanco Animal Health Incorporated	\$11.65	55.6%	\$5,738.2	\$11,441.2	\$4,442.0	\$1,100.0	24.8%	2.6x	10.4x
Freshpet, Inc.	\$67.42	91.8%	\$3,244.3	\$3,254.8	\$630.7	NM	NA	5.2x	NM
IDEXX Laboratories, Inc.	\$547.47	98.8%	\$45,442.7	\$46,651.6	\$3,431.0	\$1,074.0	31.3%	NM	NM
PetIQ, Inc.	\$16.23	88.1%	\$472.9	\$918.0	\$936.3	\$80.7	8.6%	1.0x	11.4x
Zoetis Inc.	\$171.08	91.1%	\$79,058.1	\$83,714.1	\$8,094.0	\$3,351.3	41.4%	NM	25.0x

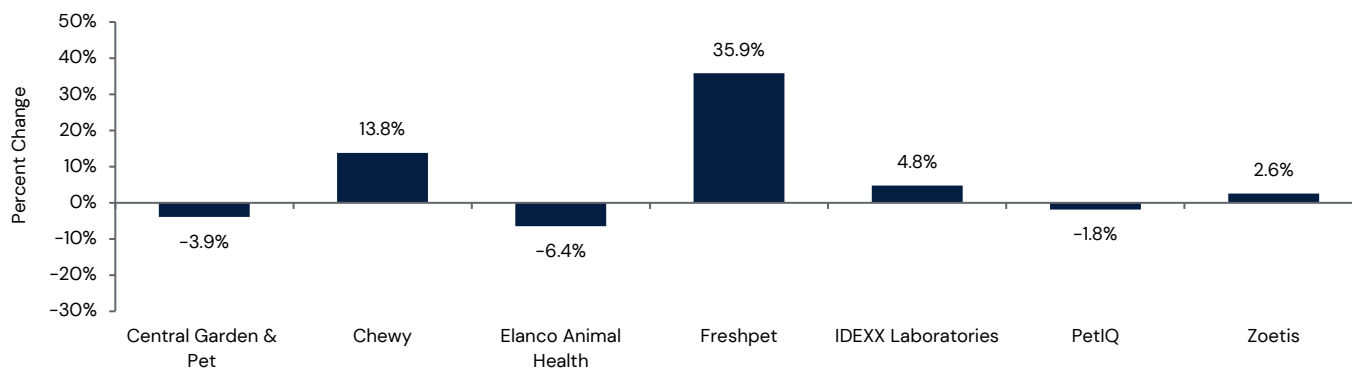
Mean	19.8%	2.3x	14.0x
Median	18.1%	1.5x	10.9x
Harmonic Mean	7.9%	1.6x	12.0x

EV = enterprise value; LTM = last twelve months
 \$ in millions, except per share data
 NM = Not Meaningful

Last Twelve-Month Margin Performance



Last Twelve Month 1-Year Revenue Growth



Source: Capital IQ as of July 19, 2023

FIRM TRANSACTIONS IN MARKET

CONFIDENTIAL

corporate sale

CAT LITTER SUPPLIER

- ▶ The Company supplies private label and branded alternative cat litter products.

CONFIDENTIAL

corporate sale

VETERINARY PRODUCTS

- ▶ The Company sells high quality medical and veterinary sutures and wound closure products.

CONFIDENTIAL

corporate sale

PET PRODUCTS MANUFACTURER

- ▶ The Company sells flea and tick medicine with a significant on-line presence.

CONFIDENTIAL

advisory services

DOG TREAT SUPPLIER

- ▶ The Company sells single ingredient dog treats.

FIRM TRACK RECORD

Capstone maintains an active Consumer Banking practice in the middle market, with the [Pet sector](#) being an important vertical within our focus. This market presence allows Capstone Partners to provide pet and animal care companies with up-to-date market data and access to key decision makers among the sector's most active acquirers and investors.



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Tom Elliott is Managing Director on Capstone Partners’ Consumer Investment Banking Team with over 20 years of investment banking experience. He has extensive experience representing branded consumer products clients, with a specific focus on the Pet Products sector. Tom joined Capstone Partners through the merger of EQV Capital Group, a middle market M&A boutique he founded in Tampa, Florida.

Prior to founding EQV, Tom spent 12 years in M&A with Citigroup Capital Strategies. Prior to Citigroup, he worked as a Corporate Finance consultant for Procter & Gamble and started his career working as a CPA for Ernst & Young.



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Sarah has more than 10 years of professional research, writing, and data visualization experience and leads the strategic coverage and development of Capstone’s middle market insights. She manages the firm’s Market Intelligence Team, which produces 150+ reports, articles, white papers, surveys, and capital markets updates each year. Her team’s award-winning M&A commentary and analysis has been featured in more than 50 of the nation’s top news outlets including *The Wall Street Journal*, *Bloomberg*, *CNBC*, and *MSN*. In 2021 she was recognized with the “Emerging Leader Award” by the M&A Advisor, which acknowledges the success of the world’s leading M&A professionals who are under the age of 40.



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Disclosure

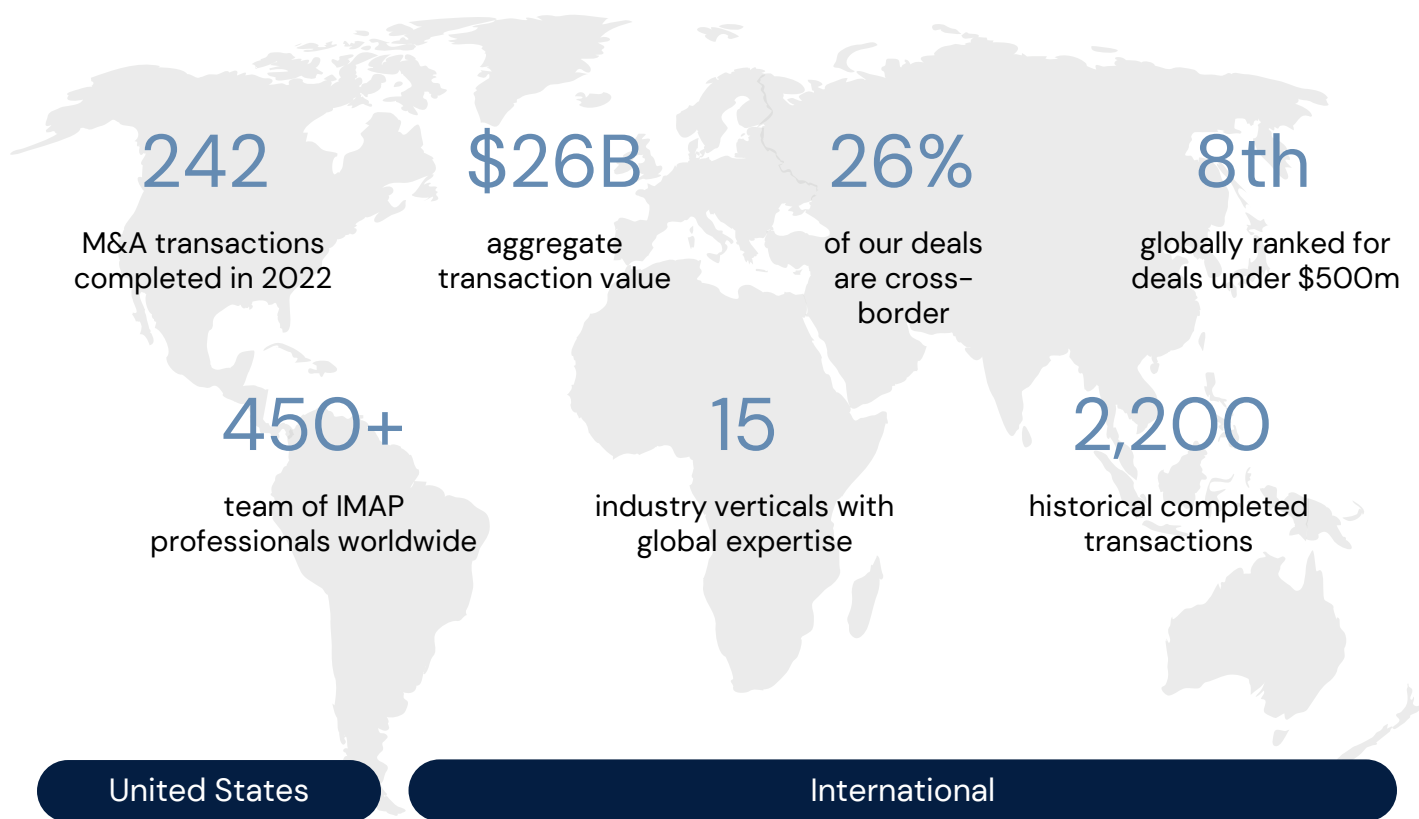
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