



HOULIHAN LOKEY

NEW DYNAMICS SHAPING THE MARKET

The Pet Industry's
Ever-Changing Course

Houlihan Lokey's sector-expert perspectives are rooted in the firm's substantial North American and European activity in the pet space.

New, far-reaching trends in consumer behaviors are bringing about a myriad of changes in the pet industry at a pace never seen before. These changes are being driven to a large extent by the "humanization" of pets by their owners, adaptations to the humanization dynamic throughout the pet supply chain, and the related reconfiguring of sales channels. In this paper, Houlihan Lokey describes how the unique convergence of these trends is redefining the pet industry, and how the evolution of the pet industry could impact the market's view of businesses.

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The Rise of Pet Ownership and Pet Humanization

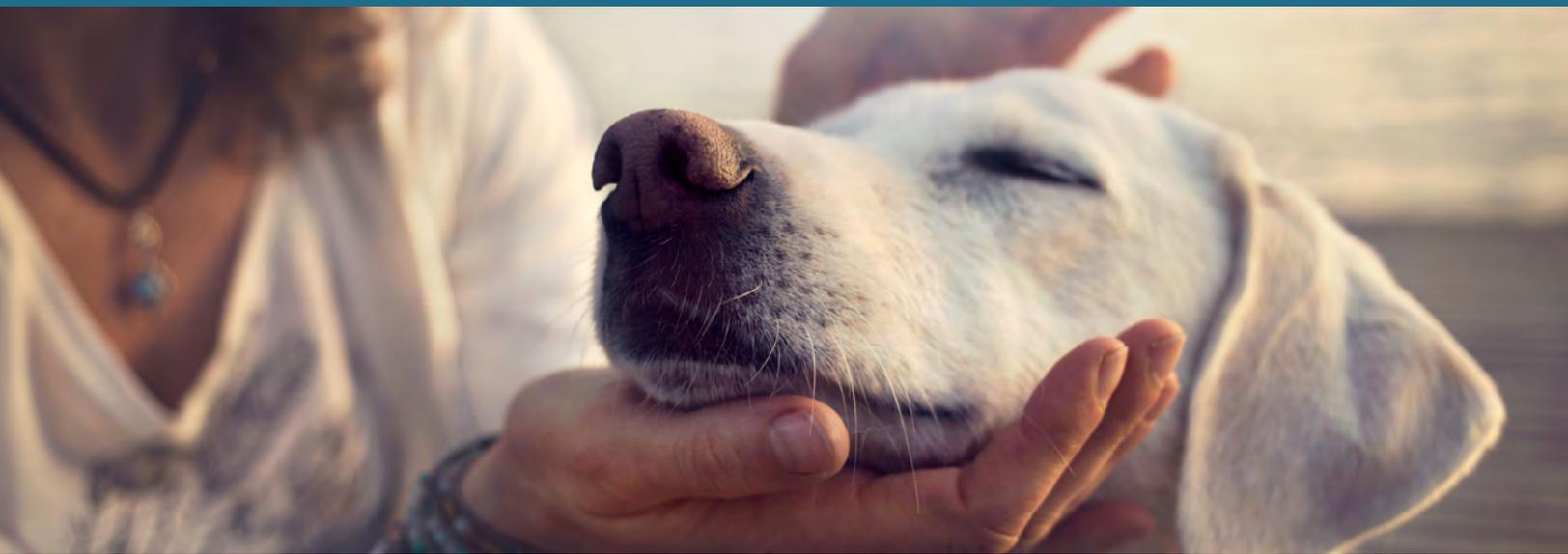
Pets have never been more popular. Today, nearly 70% of all U.S. households own a pet.¹ There are now more pet-owning households in the U.S. than there are households with children, some 84.6 million with pets compared to 52.8 million with children.² Pet spending has increased every year since 1994, and the U.S. pet food market overall is expected to reach \$30 billion in 2022, up from roughly \$26 billion in 2017,³ with the Western European market predicted to reach \$36 billion by 2022, up from almost \$27 billion in 2017.^{3a}

Recent demographic shifts have played a central role in the growth of pet ownership. Urban dwellers, a rising demographic led by millennial and Generation Z consumers, are having fewer children than their more rural counterparts. In fact, today's young adults overall are marrying and having children later in life than their counterparts in previous generations.⁴ More than half the respondents in a recent survey of men and women aged 20 to 45 said they plan to have fewer children than their parents.⁵

With 44% of millennials remaining unsure if they want to start their own family, they have been turning increasingly to pets as the next best companions. Specifically, 73% of millennials report either wanting a pet or being open to a pet.⁶ Relative to past generations, millennials have entered the workforce with significant financial anxieties, including higher levels of student-loan debt than ever before. For cash-strapped couples, a dog or cat is simply a more financially feasible option than raising a baby.

The increased interest in pets is not limited solely to younger consumers. As baby boomers have aged and their human children have grown and left home, a generation-wide case of empty-nest syndrome has set in, triggering a massive increase in pet ownership among this demographic.⁷

¹ American Pets Association
² Statista
³ Packaged Facts
^{3a} Euromonitor
⁴ eHarmony
⁵ Morning Consult 2018 Survey
⁶ Qualtrics + Accel
⁷ Wide Open Pets



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The rise in pet ownership has paralleled another important, well-established consumer trend—the health and wellness movement. Concurrent with heightened interest in the quality of their own diets, pet owners—better known today as “pet parents”—have devoted significantly more focus to what they are feeding their pets. This increasing tendency for pet parents to show the same concern for the nourishment, wellness, and care of pets as they do for that of their human family members has given rise to the term “pet humanization.”

The extent to which pets have been humanized has evolved over time. The beginning phase of pet humanization (what might be called “pet humanization 1.0”) was characterized by pet parents seeking out pet food products that offered higher quality than what historically had been available in the pet food market—premiumization. Today, more pet parents than ever are demanding not merely better quality, but also the same consumption and wellness benefits that they demand for themselves and even their own human children—a development that could be seen as “pet humanization 2.0,” a trend to natural.

The reality of pet humanization 2.0 is proven by the data. Pet food products with natural, grain-free, whole-ingredient, clean label, and sustainable product claims—historically, the types of food claims that were important to the personal diets of only the most discerning humans—are growing faster than older, traditional pet food brands. The global organic pet food market is forecast to grow at more than 9% through 2022.⁸ Google queries using terms such as “raw food diet for dogs” grew 32% between 2017 and 2018.⁹ Meanwhile, the pet food nutraceutical market is expected to grow at more than 6% through 2023.¹⁰

“Many pet parents scrutinize the food labels of what their pets consume just as carefully as the food labels of what their children consume,” said Tim Larsen of Houlihan Lokey, “and we are seeing more and more brands, including those which our firm continues to advise, being marketed with this very reality in mind.”

Equally notable is the success of companies that offer customized, individualized meal or dietary programs that pet parents can use for even more advanced care of their pets.

As Garyth Stone of Houlihan Lokey explained, “Today's pet parents want to provide their pets with a grade of food at least on par with what they themselves consume. They're also seeking customized meal plans for their pets, and in some cases even desire to spend more time in meal preparation as a tangible way to express love for their pets.” He added, “They want to give their pets the best and longest lives possible. When our firm advised Tails.com on their transaction with Nestle Purina, the ability of Tails.com to service pet parents via a D2C platform in this way was viewed as a strategically beneficial capability for the future.”

⁸ Organic Pet Food Market

⁹ Gartner L2 – Digital IQ Index: Pet Care U.S. 2018

¹⁰ Full Alliance Group



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There is more demand than ever for high-quality, differentiated pet food ingredients that improve the taste, texture, nutrition, and appearance of the end product.

Companies offering products with specific nutritional benefits to pets—akin to the nutritional benefits that humans desire for themselves—are also positioned for success in today’s market. “Our firm’s experience in advising Manna Pro underscored how focusing on specific nutritional benefits for pets can pay off,” noted Randy Chao of Houlihan Lokey. “Manna Pro was viewed as a stand-out in part because of its broad suite of nutrition-oriented products designed to support the wellness of companion pets and other backyard animals.”

Not surprisingly, pet humanization has also spawned a growing array of companies that provide special services for pets. “Our firm’s work with DogBuddy.com was an example of market interest in companies that have a unique way to benefit from pet humanization—in this case, by offering online D2C services such as dog sitting and dog walking,” Mr. Stone said. “These are services that, until recently, people would have associated with human parenting and not with pet parenting.”

The Pet Supply Chain Responds

Pet humanization is having an impact on the entire industry supply chain. Pet food ingredients, for example, are no longer the exclusive domain of commodity processors and distributors. As more pet parents feed their pets grades of food that are closer to or on par with human-grade, there is more demand than ever for high-quality, differentiated pet food ingredients that improve the taste, texture, nutrition, and appearance of the end product. Suppliers of value-added ingredients to purveyors of finished pet products have responded with rapid innovation. As a result, the U.S. pet food ingredients market is on track to grow faster than the pet food market overall, from \$10.4 billion in 2018 to \$13.3 billion in 2023.¹¹

“As recently as several years ago, pet food ingredients were viewed almost entirely as commodities,” Mr. Larsen noted. “While some of those same perceptions exist today in certain pockets of the market, there is increasing recognition that quality, innovation, and premiumization on the store shelf require these same traits from the ingredient supply chain. Well-developed specialty pet food ingredient platforms are increasingly viewed by their branded and private-label pet food customers as mission-critical partners,” he continued. “These companies have been rewarded for the innovation they have brought to the industry and we expect this to continue.”

¹¹ Markets and Markets

Dynamic Interchannel Competition

Unprecedented consumer demand for new-age pet products has produced an intensely competitive retail landscape. Traditional and nontraditional bricks-and-mortar retailers as well as online e-tailers are fighting for their share of the pet-humanization-driven dollars available in the space. Premium pet products—once the domain of independent and superstore pet specialty retailers—are becoming more broadly available in big-box grocers and mass merchants.

At the same time, the convenience and ease of ordering food online, especially for e-commerce-oriented millennials, is driving the extraordinary growth in online sales of newer age pet products.

This heightened level of interchannel competition is compelling retailers and e-tailers of all kinds to differentiate themselves in new ways. As some of the distinctions between pet specialty and mass-market retailers become less pronounced than in previous years, and as online merchandising alternatives proliferate, neighborhood pet shops and some small regional chains are finding success by focusing on the in-store experiences they provide to consumers. Delivering exclusive access to new products and brands, providing expert advice on product selection and assortment, and offering personalized services to pets and their parents have all become more commonplace.



At \$3.6 billion, pet food e-commerce now comprises 11% of the total U.S. pet food market, a leap of 53% over the previous 12 months; and Europe is only slightly behind with an estimated 10% of the pet market online.^{12a}

“Our firm’s work with Pet Supplies Plus showed us a great case study of how a bricks-and-mortar retailer is thriving in an increasingly challenging environment,” Mr. Chao said. “Through unique product assortment and special services, Pet Supplies Plus is enabling their shoppers to have a different kind of experience, the kind of experience that can be an expression of love to their pets.”

Purveyors of finished pet products also face challenges stemming from this new, competitive sales-channel landscape. The trade’s preference for unique or exclusive assortment is forcing vendors to determine which channels to focus on while managing demands from multiple channels in ways that will leave everyone satisfied as they scale their businesses.

“It seems that more and more attention from owners and managers of pet companies is being devoted to how to allocate their resources among the different classes of trade—both bricks-and-mortar and e-commerce,” Mr. Larsen offered. “The old adage is that you can’t please everyone, but companies in the industry today are being pushed increasingly to do just that. Omnichannel pet brands that are truly successful at navigating the channel conflict are seen as especially attractive as online sales continue to grow as a share of every customer’s wallet.”

¹² Nielsen
^{12a} Euromonitor

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All U.S. Consumer, Food, and Retail Transactions

All U.S. Food and Beverage Transactions

Refinitiv (formerly known as Thomson Reuters) ranks Houlihan Lokey as the No.1 M&A advisor for U.S. consumer, food, and retail as well as the No. 1 M&A advisor for U.S. food and beverage in 2019, both based on number of transactions.

Because we're No. 1 in this space and have been particularly active in pet food, we know the variables that drive appeal in the market for pet companies.

A Market on the Move

Fundamental changes in consumer behavior are re-shaping how pet parents interact with their pets and, in turn, are transforming the market for pet food and other pet products.

Impact Across the Supply Chain

The rise of pet humanization has substantially altered the entire pet industry as well as seemingly every link in the supply chain. The forces at work require innovative responses from finished pet product purveyors; pet food, product-raw-material, and ingredient vendors; retailers; and e-tailers.

Channel-Level Changes

The eagerness of retailers and e-tailers to capture this pet-humanization-driven flow of dollars has created unprecedented interchannel competition in the pet space. Finished pet product companies face critical questions, such as which channels to focus on and how to keep multiple classes of trade partners happy.





Choosing a Pet Industry Expert

In a dynamic, growing market such as the pet industry, many business owners and executives find themselves wondering if the time has come to explore a strategic growth partner or to consider monetizing the value of what they have created. It can be tempting for business owners and executives to assume that participating in an interesting market with a strong track record of performance is a sufficient formula for success, but it is not enough. Success also requires having the right advisor as the filter between a business and the market. This is where Houlihan Lokey comes in.

“We have probably completed more recent transactions in the pet space than anyone else,” Mr. Larsen said. “These transactions run the gamut of pet company types—brand marketers, manufacturers, specialty ingredient suppliers, retailers, and even distributors. They also span the entire transatlantic region. This gives us a wealth of captive insight that is invaluable to business owners and executives as they contemplate their options—what to do, when to do it, and how to prepare.”

“In addition, because we have consistently interacted with potential partners in the pet space and have insights into their priorities and direction, we can get their attention,” Mr. Stone added. “That means more options for a particular business and ultimately better strategic and financial options for business owners and executives.”

The strength of an advisor comes down to a handful of critical priorities: the quality of its collective industry relationships and the skill, experience, and creativity of the execution team.

Companies in today’s pet industry need an advisor with an impressive and sustained track record of generating strong outcomes—like the Houlihan Lokey track record. According to Mr. Stone, Houlihan Lokey’s industry credibility is built on “understanding what the market is looking for versus what scares the market, and what makes a pet business most valuable in the eyes of the market.”

Another key characteristic of a strong advisor is a high level of dialogue with industry-leading strategic and financial investors, a key advantage that Houlihan Lokey can provide based on its rich track record. “We first look at a company and identify what attributes a strategic and financial investor will view as most valuable, as well as what such parties might view as an ‘Achilles heel,’” Mr. Larsen said. “We [then] craft a story around those attributes to get the market genuinely excited. Because of our track record, we can carefully examine what factors culminated in previous successful deals and then leverage these same variables to help produce equally positive results for current clients.”



a portfolio company of
octopus ventures
has sold a majority stake to
Nestlé Purina PetCare

Sellside Advisor



a portfolio company of
THE CARLYLE GROUP
has been acquired by
Morgan Stanley
CAPITAL PARTNERS

Sellside Advisor



has been acquired by
symrise

Sellside Advisor



has completed a recapitalization transaction including an equity investment from new majority owners

Company Advisor



has received a significant growth investment from
L CATTERTON

Sellside Advisor



PET SUPPLIES PLUS
 a portfolio company of

 has been acquired by

Sellside Advisor


 a portfolio company of
 
 has received a significant
 growth investment from

Financial Advisor & Placement Agent


 has been acquired by

Sellside Advisor

Agrolimen
 has entered into a joint
 venture with

Buyside Advisor

The Houlihan Lokey Difference

Having worked with a wide array of businesses in the pet industry at multiple lifecycle stages, Houlihan Lokey can provide a smooth process and compelling strategic and financial outcomes. We consistently accomplish this, thanks to a comprehensive range of attributes that set Houlihan Lokey apart:

- Our longevity in the pet industry, which attests to our depth of experience and perspectives
- An extensive track record of successful pet-sector transactions
- Exceptional industry access to potential transaction counterparties, including industry-leading strategic and financial investors, as a result of our constant visibility in the marketplace
- Credentialed expertise across all parts of the pet sector, from brands, manufacturers, and raw material/ingredients players to retailers and distributors
- A presence in all major markets of the U.S., Europe, and Asia
- Unwavering senior-level commitment and client support

For a conversation about your business and goals, contact an advisor on our industry team.

SELECT CONSUMER, FOOD & RETAIL (CFR) TEAM MEMBERS



Jay Novak
 Managing Director
 Global Head of
 CFR Group
 312.456.4754
 JNovak@HL.com



Tim Larsen
 Managing Director
 312.456.4786
 TLarsen@HL.com



Garyth Stone
 Managing Director
 +44 (0) 20 7747 7580
 GStone@HL.com



Randy Chao
 Director
 212.497.4243
 RChao@HL.com

Tombstones included herein represent transactions closed from 2015 forward.



HOULIHAN LOKEY

ABOUT HOULIHAN LOKEY

Houlihan Lokey (NYSE:HLI) is a global investment bank with expertise in mergers and acquisitions, capital markets, financial restructuring, and valuation. The firm serves corporations, institutions, and governments worldwide with offices in the United States, Europe, the Middle East, and the Asia-Pacific region. Independent advice and intellectual rigor are hallmarks of the firm's commitment to client success across its advisory services. Houlihan Lokey is the No. 1 M&A advisor for the past five consecutive years in the U.S., the No. 1 global restructuring advisor for the past six consecutive years, and the No. 1 global M&A fairness opinion advisor over the past 20 years, all based on number of transactions and according to data provided by Refinitiv (formerly Thomson Reuters).

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