

A golden retriever and a grey and white cat are lying on a light blue tiled floor. The dog is in the foreground, looking towards the camera, while the cat is behind it, looking to the left. The background is a plain, light-colored wall.

Global Pet Expo

Baird Team Takeaways

April 2023

Baird's Pet Care Team



The Baird team is just back from Global Pet Expo 2023 in Orlando.

We met with dozens of companies who play across the pet category, attended several educational sessions spanning a wide range of topics and played with an awful lot of dogs and cats.

We left the Expo energized by how much growth continues to take place in the pet care industry, and are excited to continue partnering with founders, investors and management teams in this evolving landscape.



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Our Team's Takeaways from Global Pet Expo 2023



1. Pet Owners Spend a Lot, but Where They Shop and What They Buy Continues to Shift

2. Brand is Important; So Far, Pet Owners Do Not Seem to be Too Price Sensitive

3. Pet Ownership and Spend on Pet Care Should Continue to Rise Over Time

4. While Nothing New, Innovation Remains a Differentiator Across Categories and Services

5. 2022 Was a Record Year for Industry Spend, but a Challenge Nonetheless

6. 2023 Will Test Pet Category Resilience in the Face of Challenging Macro Conditions

1. Pet Owners Spend a Lot, but Where They Shop and What They Buy Continues to Shift

In 2022, the pet care industry generated \$77.5 billion in retail sales (excluding services), up 13% over 2021.

The online market represented nearly 40% of total pet care revenues, up 2 pts YoY, having grown ~20% in 2022. Brick and mortar sales grew a healthy 10% YoY, and we heard about an increasing level of diversification (i.e., not just food/drug/mass and specialty stores any more, its also club stores, department stores, convenience stores and brand-owned retail).

Of note, omnichannel shoppers are growing in terms of numbers of buyers (today at 41%) and in terms of what proportion of total spending they represent (today at 61%).

In terms of where pet owners are spending their money, we've seen an increase in spending on pet services (as younger consumers tend to visit the vet and the groomer more frequently than older cohorts), pet tech (as 50% of dogs now have electronic tracking devices, up from 43% just 2 years ago) and toys and treats (with 93% of pet owners spending on toys and treats, up from 90% in 2018).

The humanization of pets continues to strengthen, with 96% of pet owners identifying their pets as a member of the family, and 90% of pet owners saying that their pets are central to their home life. Interestingly, 55% of pet owners say that having a pet is important to their own physical health, while 65% of pet owners say that having a pet is important to their own mental health.



2. Brand is Important; So Far, Pet Owners Do Not Seem to be Too Price Sensitive



While the pet care industry grew 13% in 2022, most of that growth came from price increases (to offset higher inflation across raw materials & packaging as well as transportation & manufacturing). Of note, we heard that while private label did gain some market share across the pet care landscape, these gains were minimal (less than 100 bps of market share in each category).

Indeed, while the average pet owner spends nearly \$700 annually on pet care (and closer to \$1000 for cat owners given the cost of litter), there does not seem to be any softness in pet owners' willingness to spend money to care for their pets.

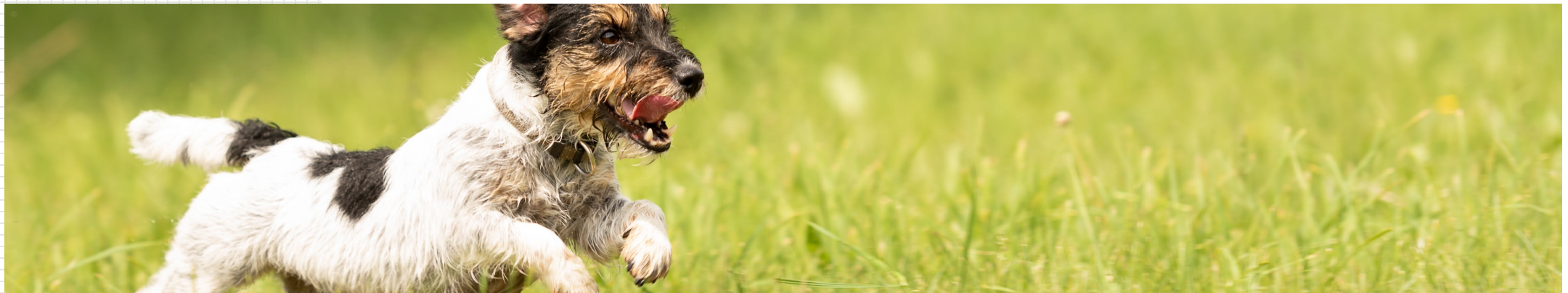
While we heard that 18% of pet owners care that a product is affordable (surprisingly more than the 13% who care that the product is safe and healthy for their pet), the fact that overall spending on pet care continues to rise seems to be proof positive that pet owners are willing to allocate a bigger and bigger slice of their household budget to care for their pets.

3. Pet Ownership and Spend on Pet Care Should Continue to Rise Over Time

Today, 66% of U.S. households have a pet, which is lower than the 70% of households that owned a pet at the height of COVID.

Interestingly, the drop in pet ownership over the last two years is solely a result of a drop in dog ownership (from 54% to 50%), as the percentage of cat and small animal ownership has not changed.

While this recent downturn in pet ownership is notable, industry experts expect the trend to revert to rising ownership in the future as younger generations of pet owners (including Millennials and Gen Z) will more than offset the recent declines from Boomers. Rising ownership rates amongst Millennials and Gen Z – both groups known to spend more on their pets compared to older generations – will be a key driver of continued pet care category growth.



4. While Nothing New, Innovation Remains a Differentiator Across Categories and Services



Given the strong growth trends in both pet ownership and spending on pet care products, we met with many companies focused on meeting the needs of pets and their owners in new and innovative ways.

Pet vitamin/mineral/supplements has been a hot space for several years (in part due to its generally high profit margins) and continues to be popular, with more companies launching new products to help keep pets healthier, both physically and mentally. We learned that nearly 40% of all dogs have been fed a CBD product at one point, and many companies have launched toys and treats to help soothe the frayed nerves of their pups.

Indeed, we saw real evidence that “wellness” for pets is no longer exclusive to pet food, but rather now includes puzzles, games and durables such as licki-mats to stimulate both physical and mental activity.

In terms of services, we heard about several traditional retailers that are expanding their pet care services. For example, Walmart is partnering with Best Friends Pet Hotel to offer doggie day care in select stores (in addition to existing PetRx offering, and partnerships with Rover and Fetch), and Pet Supplies Plus began offering a broader assortment of grooming services at their stores in an effort to strengthen its omni-market offering.

5. 2022 Was a Record Year for Industry Spend, but a Challenge Nonetheless

From a high level, 2022 was a great year for the pet industry, as pet owners continued to spend a lot of money taking care of their pets. However, in talking with the management teams of companies engaged in various aspects of pet care, we heard a lot about the challenges they faced last year, in terms of their inability to meet demand due to supply chain bottlenecks (including staffing shortages), inventory reductions at retail pressuring their shipments (even if sell-through rates remained high) and persistently high levels of inflation (while there has been relief in freight, other costs remain high).

While most companies told us that they implemented price increases to mitigate cost pressures, it sounds as if the profit margins for many pet care companies are still under pressure. Additionally, we heard from several folks about the lack of manufacturing capacity – especially in kibble – and the long lead times to procure manufacturing equipment, which has led to higher rates from contract manufacturers and a greater desire for vertical integration on the part of pet care companies.

These challenges notwithstanding, the level of enthusiasm from the management teams we spoke to about positioning their businesses well for future profitable growth seemed robust across the board.

6. 2023 Will Test Pet Category Resilience in the Face of Challenging Macro Conditions



The educational sessions we attended focused on 2022 data, and a few offered perspective on how consumer behavior might change in 2023 given the difficult macro backdrop (with an uncertain outlook pertaining to employment levels, interest rates and inflation, all of which could meaningfully impact consumer spending).

However, nobody went so far as to offer a specific outlook with regard to 2023 pet care industry growth rates. While industry experts expect to see mid-to-upper single digit growth for the category in aggregate through 2026, certain categories and channels within pet care are likely to fare better than others.

Our early read based on YTD tracked retail sales and consumer traffic trends suggest inflation and concerns around the state of the economy have begun to impact pet care spending (albeit modestly when compared to other more discretionary categories). While YTD tracked retail sales data (through February) shows top line dollar growth, a drop in unit volume suggests most growth is coming from price / inflation. Consumer foot traffic volume (through mid-March) highlights a similar softening, with YTD foot traffic down ~4% at leading specialty players. We'd point to a potential bright spot within the independent channel, with a leading channel player posting modest gains in traffic YTD.

All that said, it's too early to draw any conclusions on full-year potential given a rapidly evolving macro environment. Our team remains optimistic that overall category performance will remain resilient; a safe bet is that folks continue to see profitability growth outpace top line growth as supply chain pressures continue to subside.

Baird's Comprehensive Experience Across Pet Care



Nutrition

Products & Supplies

Retail & Service

freshpet

\$350,000,028
Common Stock

Follow-on Offering

freshpet

\$345,345,000
Common Stock

Follow-on Offering

CENTRAL
Garden & Pet

\$200,000,000
Common Stock

Follow-on Offering

\$625,000,000

CLAYTON
DUBILIER
& RICE

Acquisition of

RADIO SYSTEMS
CORPORATION

Senior Secured Notes

PET SUPPLIES PLUS.

A Portfolio Company of

Sentinel
CAPITAL PARTNERS

Sale to

FRANCHISE
GROUP INC.

PET SUPPLIES PLUS.

A Portfolio Company of

IRVING PLACE CAPITAL

Sale to

Sentinel
CAPITAL PARTNERS

Freshpet

\$179,687,505
Common Stock

Initial Public Offering

Undisclosed Value

Freshpet

Sale of 25% stake to

Tyson

Caring for pets since 1868

Sergeant's

Sale to

Perrigo

Rejuvenate.

Sale to

Spectrum
Brands

petco
THE HEALTH +
WELLNESS CO.

\$607,200,000
Common Stock

Follow-on Offering

petco
THE HEALTH +
WELLNESS CO.

\$993,600,000
Common Stock

Initial Public Offering

nulo
healthier together™

Received Minority Investment from

Apax

Advisor

WellPet
at the heart of all we do™

A Portfolio Company of

CLEARLAKE CAPITAL

Senior Secured Credit Facilities

WEIMAN

A Portfolio Company of

CORTEC Group

Sale to

THE CARLYLE GROUP

And

TA ASSOCIATES

Bradshaw Home

A Portfolio Company of

ONCAP

Sale to

ARBOR
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ROARK
CAPITAL GROUP

Acquisition of

petvalu

* Tombstones denote transactions completed by bankers while at another firm.

