The Evolving Pet Retail Landscape and the Broader Impact on the Pet Sector

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The pet retail sector continues to generate strong momentum against a backdrop of numerous favorable industry trends:

- The "pets as family" trend is as strong as ever, with 95% of pet owners considering their pets to be members of the family and willing to purchase premium products for their pets.
- Better-for-you trends are extending from consumers to their pets ("humanization"), which is creating new verticals within an already diverse sector and fueling growth in the pet care industry.
- Favorable demographic trends within both baby boomers and millennials continue to drive pet ownership with more U.S. households now having pets than children.

The U.S. pet product industry is recession-resistant, as proven during the last financial downturn. As a result, and as evidenced in a recently closed Lincoln pet sell-side transaction, strategic and financial investor interest in the sector remains strong. This is despite nearly 60% of consumer investors believing that an economic slowdown is likely to occur in the next 2-5 years, while just less than 40% anticipate a slowdown next year, according to a recent Lincoln survey.

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Based on our recent experience, one trend that investors are highly focused on at present is sales channel mix, in particular how traditional brick-and-mortar pet retailers are seeking to navigate the increasing share of sales that are occurring online vs. in-store. Pet care is the fastest growing category in CPG e-commerce and is expected to continue double-digit growth rates through the end of 2020. Retailers that have historically focused on brick-and-mortar locations are actively navigating the changing competitive landscape, to differing degrees of success. For example, PetSmart's acquisition of Chewy was intended to accelerate PetSmart's transition, but it has also carried with it unintended turbulence, including navigating channel conflict and effectively leveraging the brick-and-mortar footprint to support online sales.

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While the option of developing your own, proprietary e-commerce platform can take longer, it can help create customer loyalty and further deepen customer relationships. In addition, how to compete with longtime e-tailers such as Amazon can also create its own difficulties, especially with the material shipping costs associated with heavy packages (with Amazon continuing to offer free shipping). As investors consider acquisitions in the pet food or product space, they want to understand how target companies are navigating this macro shift to online, including any potential channel conflict with the same brands being sold through different channels at different prices and if the target has its own proprietary e-commerce platform.

A number of brick-and-mortar retailers are seeking to offset declining foot traffic caused by the shift to online by expanding their service offerings and being more thoughtful as it relates to the brands and products they carry in store. Deepening the service offering can help to bring in more "pet parents" and meaningfully increase the average spend per visit. Petco, as one example, recently expanded to offer broader vet services, while also growing their offering related to training, grooming and daycare, with the goal of drawing in consumers who can then make additional in-store purchases. Related to this, brick-and-mortar retailers are also demonstrating increased focus when deciding which brands and products to carry in-store, shrinking their offerings and focusing on brands that can demonstrate strong consumer engagement to drive consumers traffic to a brick-and-mortar retailer rather than e-tail. This creates an opportunity for retailers to innovate and develop their own portfolios of branded pet food and pet products. It is also driving investors to dig deeper during diligence to assess the strength of brands of targets they are considering acquiring to ensure there is real brand value and there is little-to-no, or controllable, private label risk.

The increase of contract manufacturers and private label partners has created more options than ever to create brands and products without having to invest significant capital. The primary advantage of this is that retailers can leverage the data they have on customer buying behavior to curate products that consumers are demanding, with such products also often generating higher profitability for the retailers than third party products. The implications of this to companies supplying into these stores can be far reaching.

CONCLUSION

Given the size of the pet industry and positive macro trends, the pet space will remain hot and generate interest from strategic and financial investors alike. In terms of retailers, investors will continue to focus on how the retailer is managing the shift to online and their strategy for attracting incremental consumer traffic. When it comes to pet food and pet products, investors will always want to understand the channel strategy and how the target is managing potential channel conflict, combined with any potential private label headwinds, as well as the strength of each brand they are potentially acquiring.

ABOUT THE AUTHOR:

Charles Walder is a Director in the mergers and acquisitions advisory business at Lincoln International. He has a deep understanding of the core value propositions of successful pet companies, as well as the characteristics that acquirors across the world are looking for in targets in the sector.