



Pet Products and Services

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Treats and Supplements Emerge as Attractive Categories on the Periphery of the Pet Food Bowl

While pet food has garnered the most attention, treats and supplements present the most compelling opportunities for investors and acquirers to tap into the pet industry's strong growth trends.

The COVID-19 pandemic affected consumer behavior in myriad ways, including pet ownership. During the global lockdowns, many households decided to add a furry friend to their families, driving a significant increase in new pet ownership. According to a William Blair survey of pet owners, nearly 30% of respondents reported they had adopted a new pet within the past 12 months and one-third are either highly or somewhat likely to adopt an additional pet in the next 12 months. These figures appear in line with broader pet industry data. For example, Chewy, the leading e-commerce pet company, reported

on its fourth quarter 2020 earnings call that its users had registered 35% more profiles for puppies and kittens in 2020 than in 2019, along with 40% more profiles for newly adopted pets.

The large number of dogs, cats, and other animals added to families during the pandemic has accelerated opportunities for investors seeking to capitalize on this growth as well as the increasing humanization of pets. The American Pet Products Association (APPA) estimated that U.S. consumers spent a total of \$103.6 billion on pets in 2020, a number that is anticipated to grow to \$109.6 billion in 2021.

Large and Growing U.S. Pet Market

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Total U.S. Pet Industry Expenditures by Company in 2020 (\$ in billions)



Source: American Pet Products Association. Data as of March 24, 2021. "Other services" include boarding, grooming, insurance, training, pet sitting and walking, and all services outside veterinary care

The pet industry has already attracted widespread interest and capital from investors and strategic acquirers. Most of this interest has been focused on the pet food segment, resulting in a sequence of high-profile transactions and significant banking coverage. Meanwhile, the market for treats and supplements—though currently much smaller—is growing at a much faster rate and has drawn less attention.

As investors and strategic acquirers look for opportunities to gain exposure to the trends driving growth in the pet industry, we believe that the treats and supplements segments present particularly compelling opportunities. “Pet parents” have become increasingly concerned about the health and well-being of their pets, leading to rapid growth in clean-label treats and supplements. Buying behavior has shifted, and online delivery and direct-to-consumer channels have grown significantly, particularly for supplements. Amazon and Chewy, in particular, have emerged as key channels for the supplement market, which has blossomed alongside the rapid growth in e-commerce in recent years. These trends largely mirror the mega-trends shaping the human food and beverage industry, especially as the pandemic highlighted the importance of doing more to stay healthy amid a global medical crisis.

To help investors interested in the pet industry gain more insight into the

opportunity set in pet treats and supplements, we examine the main drivers behind the industry’s strength and share takeaways from a recent survey we conducted about pet owner behavior. We also provide recommendations for how investors can seek to capitalize on these trends.

Highlights From Our Survey

Given the importance of the treats and supplements segments and the relatively little focus they are receiving, we surveyed 400 pet owners in April 2021 to better understand their priorities and purchasing habits for treats and supplements. We provide takeaways from that research into areas such as shopping behavior, purchase considerations, and a range of other questions in each category.

Market Size and Breadth

Freedonia estimates that U.S. retail sales of dog and cat food will reach \$37.9 billion by 2024, representing a compound annual growth rate (CAGR) of 5.6% from \$28.9 billion in 2019. Retail sales of pet treats and chews in the United States are forecast to reach a total of \$7.5 billion in 2023, representing a CAGR of 2.8% from a total of \$6.5 billion in 2018. The pet supplement category is smaller, totaling approximately \$800 million as of 2020, but appears to be growing much faster. Pet supplement sales skyrocketed 21% in 2020. While the supplements market may seem small,

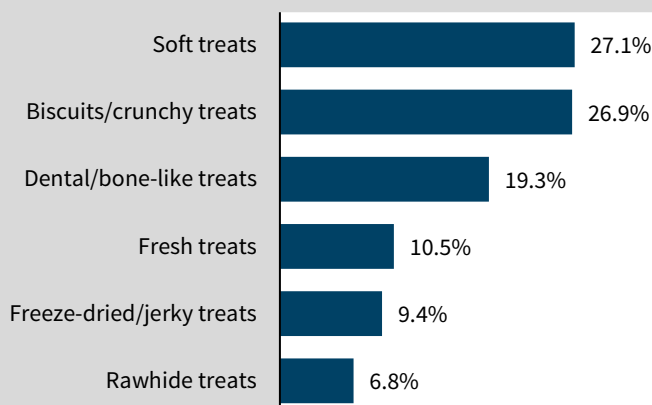
investors are seeing opportunities for trusted supplements brands to expand into treats and capture some of that market share.

Understanding the breadth of the treats and supplements categories provides valuable context into the opportunity set. Our survey found that pet owners are purchasing a wide range of formats of treats and supplements, showing the range of options even within each segment. Supplements now treat a variety of conditions, ranging from traditional concerns such as promoting skin and coat health to soothing stressed-out pets.

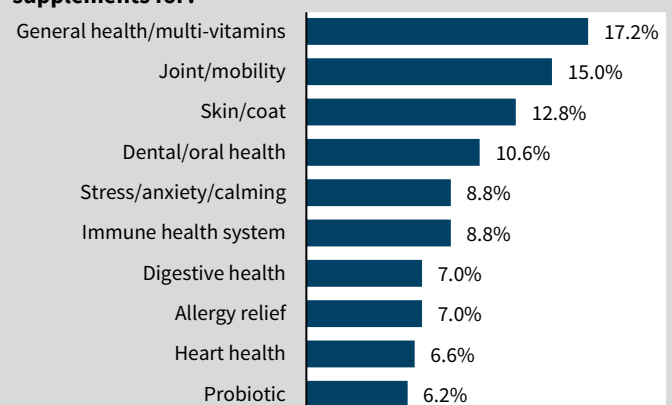
Specific options available to pet parents have grown over time as companies—including leading supplement brands such as Zesty Paws, PetHonesty, Nutri-Vet, Doggie Dailies, and Native Pet—continue to invest in innovation. For example, Zesty Paws offers CBD-infused supplements that aim to help pets increase their mobility, enhance their immune systems, and foster better behavior. PetHonesty, Nutri-Vet, and Native Pet all have strong positions in probiotic supplements, which have emerged as a significant category in recent years. Pet probiotic and prebiotic supplements from these brands and others can be used to foster a healthy digestive tract and address seasonal allergies, among other potential benefits.

Pet Owners Purchase a Breadth of Treats and Supplements

Treats: What types/formats of treats do you buy?



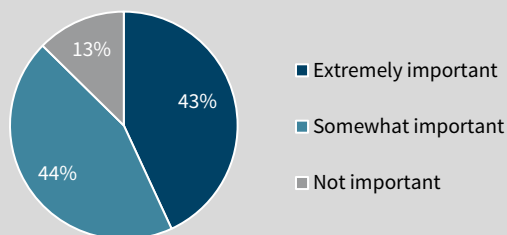
Supplements: What types of conditions do you buy pet supplements for?



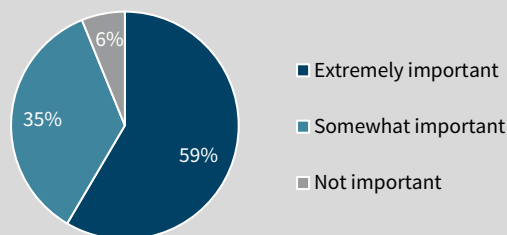
Source: William Blair survey, April 2021

Clean Label is a Priority for Pet Owners

Treats: How important is it for you to buy clean-label treats for your pet?



Supplements: How important is it to buy clean-label supplement products for your pet?



Source: William Blair survey, April 2021

The wellness theme has carried over to the treats segment as well. One of the largest pet treat manufacturers—the J. M. Smucker Company—has significantly expanded its offerings through investments in treat brands focused on all-natural ingredients. Smucker’s brands include Milo’s Kitchen and Rachael Ray Nutrish, both focusing on “real” food in a variety of treat formats beyond traditional biscuits. These treat formats often come in fresh or freeze-dried formats, some of which even mimic human food flavors such as hamburgers and pasta. The emphasis on more natural ingredients includes pet food as well, with more brands offering fresh foods as well as freeze-dried, “cleaner” kibble with fewer additives and fillers.

Focus on Wellness and Clean Labels

Just as human consumers are paying far more attention to the quality and ingredients of their food than in the past, pet owners have increasingly focused on the same characteristics

for their pets. This is in part because pet owners tend to consider pets as more than just companions. In our survey, 98% of pet owners stated that they considered their pets to be members of their family.

Because the pandemic forced consumers to pay attention to their health and well-being, it is not surprising that pet parents are paying close attention to their pets’ health as well. Of the survey respondents who purchase supplements, nearly 60% of them said that they are paying closer attention to their pets’ health and wellness because of the pandemic.

Factors Driving Purchasing Decisions

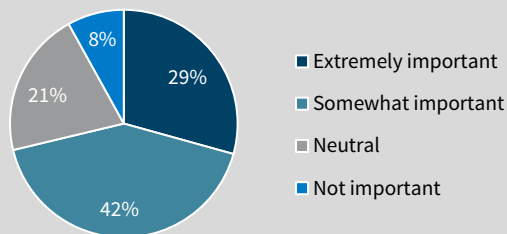
The survey results revealed some nuances in the factors that drove purchases of treats and supplements. For both treats and supplements, the quality of the product’s ingredients was the single-most important factor in the purchasing decision, and a trusted brand was among the top three most important factors in both

categories. For supplements, the product’s efficacy was also a crucial purchasing factor and ranked just behind the quality of ingredients in importance. The emphasis on the efficacy of supplements suggests that pet owners are concerned that the supplements deliver on their promised benefits and help improve their pets’ lives. Purchasing from a trusted brand played a larger role for supplements than for treats, which seems to correspond with the idea that pet owners are seeking supplements for their medical/health benefits rather than just as a reward for their pets.

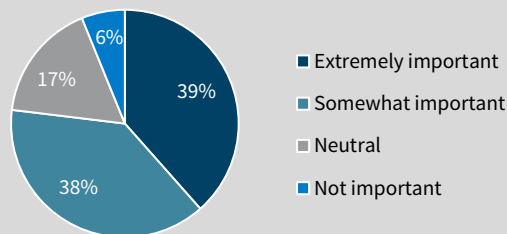
Interestingly, nearly half of respondents (46%) said that price was the least important factor when purchasing supplements and 34% said that price was the least important factor when purchasing treats. This highlights the low degree of price sensitivity for both categories and supports the investment thesis that pet products are a relatively recession-proof industry.

Brand Names Carry Weight

Treats: How important to you is brand name vs. generic/private label?



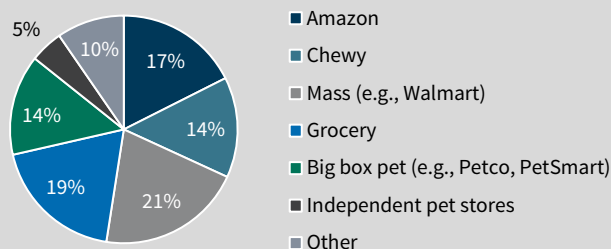
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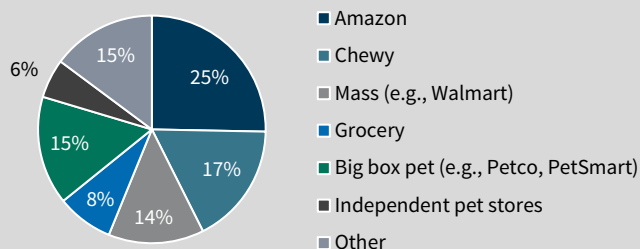
Source: William Blair survey, April 2021

E-commerce and In-store Retail Differ in Prominence

Treats: Via what channel did you purchase pet treats?



Supplements: Via what channel did you purchase pet supplements?⁽¹⁾



(1) "Other" includes farm and feed stores, club, other third-party online retailers, and brand website/direct-to-consumer"

Source: William Blair survey, April 2021

A Shifting Purchasing Landscape

The COVID-19 pandemic rapidly accelerated the growth of e-commerce in all areas, and the pet industry certainly benefited from this trend. Online sales are dominated by Amazon and Chewy, both of which are experiencing exploding growth in pet spending. William Blair equity research analyst Dylan Carden estimates Chewy can capture over 50% of incremental pet spending that will move online.

While online sales have grown significantly, in-store retail is still an important, albeit evolving, channel. For example, online sales appear to be hurting large pet-focused retailers such as PetSmart, though other retailers—including Walmart, Target, Costco, and drugstores—are emerging channels. Some of these major retailers are also seeing meaningful sales volumes on their websites, contributing to the overall shift to purchasing via the online channel. The subscription model, usually managed

through an online presence, also has grown in popularity, particularly for supplements. More than 40% of our survey respondents said they were interested in a subscription for supplements on a monthly or quarterly basis, with another 28% responding as slightly interested.

While the online channel has demonstrated significant growth, responses to our survey show the continued relevance of in-store purchases, particularly for treats. Pet owners bought and learned about supplements primarily online; this is likely because supplements represent a relatively young category that has grown in prominence during the e-commerce age. Despite the continuing shift toward e-commerce, treats remained primarily an in-store retail purchase. The survey results suggest that treats are more of a purchase of convenience rather than the result of extensive research.

The differences in buying behavior indicate that supplements are a higher-consideration purchase than treats, which corresponds to the emphasis on efficacy in driving the purchase decision. While the purpose of treats is to serve as an enjoyable reward or a training mechanism, supplements are seen as a way to improve a pet's overall well-being. Indeed, a higher percentage of pet owners stated that they were willing to pay a premium for supplements than they would for treats (78% vs. 60%). As noted above, pet owners valued a trusted brand for supplements more than for treats, suggesting that a company focused on supplements could be better positioned for a higher-value-added offering.

Awareness Reflects Channel Preferences

Treats: How did you first learn about pet treat products?



Supplements: How did you first learn about pet supplement products?



Source: William Blair survey, April 2021

Major Transactions Highlight a Focus on Pet Health and Wellness and E-commerce

The pet industry has historically attracted significant attention from financial sponsors and strategic acquirers looking to capture the industry's strong growth trends and emphasis on healthy offerings. General Mills' \$8 billion acquisition of "wholesome natural" pet food company Blue Buffalo in 2018 and the J.M. Smucker Company's \$5.8 billion acquisition of Big Heart Pet Brands, a deal on which William Blair advised Smucker, signaled the importance of pet food in a diversified CPG company's portfolio. Chewy's 2019 IPO, in which William Blair served as an underwriter, demonstrated the power of e-commerce to reach pet owners and the importance of online delivery.

More recently, William Blair has been involved in several transactions that reflect the growing and broad-based interest in the pet industry, particularly involving the wellness theme:

- **Freshpet follow-on offerings:** William Blair served as an underwriter of Freshpet's follow-on public offerings in February 2020 and February 2021. Freshpet, a disruptive direct-to-consumer business model in the pet food market, creates natural pet food made from a blend of fresh meats, vegetables, and fruits farmed locally and made in-house.
- **Manna Pro acquired by Carlyle Group:** In November 2020, William Blair advised Manna Pro Partners on its sale of a majority stake from Morgan Stanley Capital Partners to the Carlyle Group. Manna Pro manufactures and markets specialty pet care products, including supplements, food, treats, and other health and wellness products.
- **Perrigo sells animal health division to PetIQ:** William Blair advised Perrigo Company on the 2019 sale of its animal health division to PetIQ, a pet health and

wellness company. Perrigo Animal Health is a leading provider of over-the-counter animal health products that allow consumers to proactively prevent or treat conditions that can be self-managed.

- **PetIQ IPO:** William Blair served as co-lead bookrunner on PetIQ's IPO in July 2017. PetIQ is a leading pet health and wellness company that has continued to grow in recent years. The company's successful IPO signaled strong demand for wellness-related pet offerings, an area that has boomed since 2017 and should keep expanding in the years ahead.

Finding Opportunity in a Well-Covered Industry

In addition to overall increases in pet ownership, innovation and brand awareness are driving growth for companies across the pet industry. As consumers increasingly view their pets as members of the family, demand for premium products with more natural/better-for-you ingredients and other wellness benefits will continue to see surging demand. And this demand will be particularly robust for brands that effectively leverage e-commerce and direct-to-consumer channels.

While pet food is extremely competitive, there are significant opportunities for financial sponsors and strategic acquirers in the rapidly growing treats and supplements segments. These areas, which are well-aligned with the wellness and e-commerce mega-themes, are primed for significant acquisition activity in 2021 and beyond.

To access the full survey results and dive deeper into the trends shaping the growth of the pet industry, please contact us.

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