



Pet products and services are converging

Get in on the trend or risk
getting left behind.

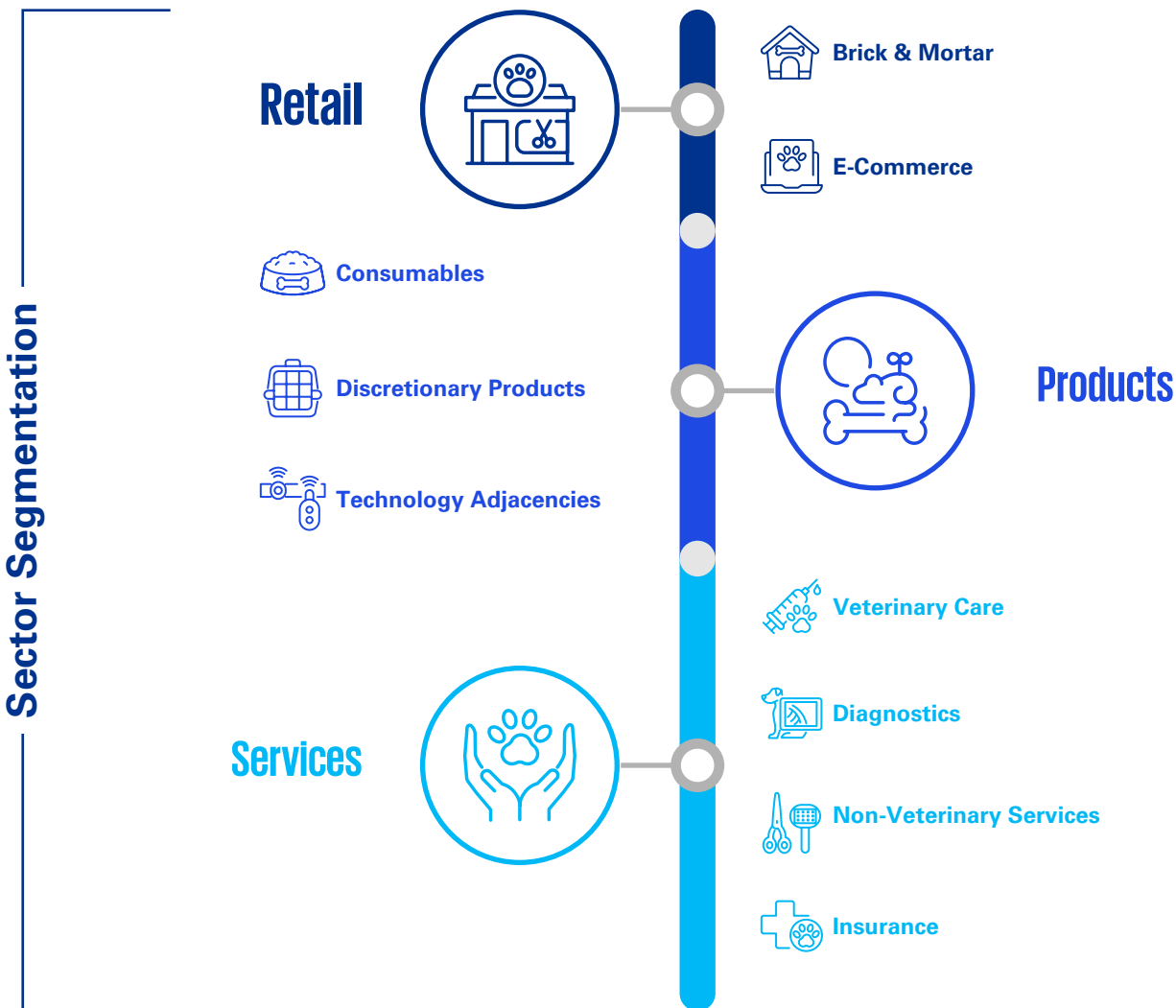
Introduction

Following decades of growth of the overall pet sector,¹ recent trends show different segments across the sector are increasingly converging. Traditional retailers are expanding their services. Service providers are exploring insurance offerings. Consumables producers are adding wearables and other adjacent technologies to their portfolio.

This convergence trend is driven by several factors that impact different traditional players in different ways, but it is prompting all players across the pet sector to reassess their portfolio, target customer, and market positioning. Companies and private

equity firms in the sector must decide whether their offering is differentiated enough to survive as an independent niche offering, if it is time to maximize value by becoming an acquisition target, or if they are positioned to take advantage of the convergence trend.

In this paper, KPMG provides an overview of the growing trends across the pet sector, the increasing focus on convergence across sub-sector categories, and why companies in the space are being challenged to take part in the trend or risk getting left behind.



¹ Source: "C&R portfolios 2023: Business cycle implications," KPMG.com, 2023

Pet sector business is booming

With the multi-decade trend of increasing pets-per-household and the increasing focus of pets as a member of the family, the pet sector has exhibited growth in every segment over the past decade. Total spend on pets grew from \$53.3 billion in 2012 to \$136.8 billion in 2022, a compound annual growth rate of 9.9

percent—and is expected to reach \$143.6 billion this year.² Pet owners of all kinds are investing more in their cats, dogs, birds, and reptiles—opting for nutritional feed options over old-school kibble, making more frequent visits to the vet, and expressing more eagerness for new services such as pet health insurance.

Total U.S. pet industry expenditures³

Year	Billions of dollars
2023	\$143.6 (projected)
2022	\$136.8
2021	\$123.6
2020	\$108.9
2019	\$97.1
2018	\$90.5
2017	\$69.5
2016	\$65.8
2015	\$60.3
2012	\$53.3

While much of the sector growth has been driven by macro factors such as household pet penetration and increases in consumer discretionary spending, changes in consumer behavior at a sub-sector level have led to bottom-up growth across all corners of the pet ecosystem—including retail, health and

nutrition, products and services, and technologies and other adjacencies. With growth occurring everywhere in the sector, traditional players are asking themselves whether they can find synergistic value by expanding across other segments of the broader ecosystem.

² Source: "Pet Industry Market Size, Trends & Ownership Statistics," americanpetproducts.org, March 2023

³ Source: Ibid



Convergence is the new trend

Alongside organic growth strategy and product development, many leading players in the pet sector have capitalized on strategic merger and acquisition (M&A) opportunities in recent years. Much of this activity has been focused on market share or geographic expansion, product diversification, or cost synergy opportunities. For example, traditional pet food companies have acquired fresh, health-conscious brands, and veterinary aggregators have continued to accumulate

more share. Increasingly, companies and private equity sponsors alike are seeing value in M&A opportunities that drive convergence across traditional segments. Customer brand loyalty, end-to-end ownership of customer data and insights, and pull-through sales opportunities between products and services are allowing companies to unlock top-line synergies and significantly accelerate value creation opportunities.

Convergence case studies:

A pet food powerhouse moves into services, technology, and adjacencies.



- Mars has been a global leader in pet food and treats for decades—adding to legacy brands like Pedigree and through acquisitions of Royal Canin (2002), Greenies (2006), and IAMS (2014), amongst others. More recently, Mars Petcare has increased its focus on health and nutrition within its food segment through acquisitions such as Crave (2017) and Champion Petfoods (2023).
- Health products and technologies joined the portfolio organically through the rollout of DNA testing product Wisdom Panel (2007), followed by acquisitions of Whistle GPS tracking (2016) and other key strategic investments.
- To further own the customer experience across products and services, Mars made the move into

veterinary care through an initial investment (1994) and ultimate acquisition (2007) of Banfield—the largest aggregated network of veterinary care practices globally at the time. This move was later emphasized through the acquisitions of BluePearl (2015) and VCA (2017), a focus on Europe through acquisitions of AniCura and Linneaus (2018), and an emphasis on Asia through acquisitions of VES and VSH (2020).

- Further unlocking the intra-portfolio synergies on the services side, Mars has recently enhanced its diagnostic capabilities through acquisitions like Genoscoper (2018), Antech Diagnostics and Sound (2017), and Heska (2023, pending regulatory approval).

⁴ Source: "Online Pet Food & Pet Supply Sales in the US - Market Size," IBISworld, January 10, 2023

⁵ Source: "Pet stores Industry in the US" IBISworld, March 22, 2023

⁶ Source: Proprietary KPMG Research

⁷ Source: "Petcare Industry Outlook 2030" Morgan Stanley November 2, 2022



1. Sub-sector trend: Retail manages changes in channel dynamics

- Similar to trends across the broader retail sector, specialty pet retail has seen a shift in consumer channel trends over the past decade. Between 2018 and 2023, online pet product sales grew at a 15.6 percent compound annual growth rate (CAGR).⁴ Meanwhile, brick-and-mortar sales grew at 4.0 percent CAGR between 2018 and 2023, with an estimated growth rate falling to 0.3 percent in 2023.⁵
- Trends for leading specialty pet retailers show that growth in observed customers per year for e-commerce has greatly exceeded traditional brick and mortar, +25 percent CAGR versus +2 percent CAGR from 2017 to 2022. Additionally, while average transaction volume has grown at a 4 percent CAGR across both channels, growth in average transactions per customer for leading e-commerce retailers has outpaced brick-and-mortar peers, 8 percent to 3 percent.⁶
- A major driver of the shift in consumer behavior is tied to increasing demographic trends of the consumer base. As of 2022, 77 percent of 18 to 34 year olds and 73 percent of 35- to 54-year-olds report owning a pet, with largest growth in pet ownership in recent years among 18- to 34-year-olds.⁷

A private equity sponsor moves towards a unified theory of services.



- While many corporations and private equity sponsors have taken part in the broad shift towards veterinary clinic aggregation, Luxembourg-based JAB has taken a leading position on convergence across the services side of the pet sector.
- JAB's first foray into the pet sector was through its acquisitions of general veterinary services provider National Veterinary Associates (NVA) and specialty and emergency provider Compassion-First Pet Hospitals (2019). Having added to the portfolio through its acquisitions of Ethos (2021) and SAGE (2022), JAB has aggregated a leading provider of pet health services under its NVA and Ethos banners.
- Seeing the returns on its investment in pet, and the potential benefits from owning the end-to-end customer data

and experience, JAB announced a new \$5 billion fund to be focused on further petcare investments (2021). JAB acquired Cardiff Pinnacle in the UK and Figo Pet Insurance in the US (2021) to move into the growing pet insurance market. JAB furthered the focus through its acquisitions of C&F Pet and Pethealth (2022) and its separate acquisition of Agila to further expand its European focus (2022). JAB's broader pet insurance portfolio has acquired upwards of 15 brands—operating under its Independence Pet Group platform in the US and its Pinnacle Pet Group platform across Europe.

- A focus moving forward appears to be in diagnostic and adjacent health services space, with JAB's current portfolio including Veterinary Pathology Group.



2. Sub-sector trend: Products and nutrition go beyond the traditional

- Nutrition remains the largest segment of the pet sector, with sales projected to reach \$62.7 billion in 2023 and growing at a CAGR of 8.5 percent.⁸
- Pet food has become increasingly health oriented in recent years as owners trade up to customized pet meals that target a pet's age, breed, and other individual health factors. The fresh pet food market has dramatically outpaced the overall market, with forecasted growth at 24 percent CAGR from 2021 to 2025, representing incremental growth of \$8.64 billion.⁹
- The rise in fresh food has impacted retail channel dynamics, as fresh products tend to have a shorter shelf life than traditional packed food products. Direct-to-consumer e-commerce channels provide retailers with more real-time inventory fulfillment control.
- It is expected that connected pet and adjacent technology products will become an increasingly prevalent segment moving forward, with growth estimated at 15 percent CAGR for the next decade to over \$35 billion in 2032.¹⁰



⁸ Source: "Pet Industry Market Size, Trends & Ownership Statistics," americanpetproducts.org, March 2023

⁹ Source: "Growth in Fresh Pet Food Market in US 2021-2025" PRNewswire, February 23, 2021

¹⁰ Source: "Pet Tech Market" Global Market Insights, February 2023

A brick-and-mortar retailer looks beyond traditional consumable and discretionary sales.



- Legacy retailers have focused on channel diversification for years with an eye towards the future of consumer sales. While investment in e-commerce channel development has been squarely in focus, for pet retailers like Petco, broader portfolio diversification has been a primary driver of growth in recent years.
- Petco has invested in strategic partnerships and alternative store concepts to further reach a more diverse customer set. In 2022, Petco announced a partnership with Lowe's, launching a shop-in-shop concept that includes a curated selection of products and nutrition as well as select veterinary clinic services during peak hours.
- With the goal of being a one-stop shop for all pet needs, Petco launched its first in-store veterinary clinic through joint ventures with Thrive Affordable Pet Care and The Pet Vet (2017)—operations Petco took fully internal by 2022. Petco has seen a rapid

expansion of veterinary care being offered through various channels—including in-store veterinary clinics and its Vetco mobile clinics. As of 2023, Petco employs more than 1,000 veterinarians and provides veterinary care at over 90 percent of its physical locations.¹¹

- Petco has also looked at a partnership model to enhance its stake in consumables and discretionary product sales, targeted at specific customer sets. On the nutrition side, Petco announced a partnership with fresh dog food manufacturer JustFoodForDogs that includes exclusive brick-and-mortar sales as well as co-production of exclusive white-label fresh food products (2018). On the products side, a partnership with Backcountry—an e-commerce retailer for camping, hiking, and other outdoor equipment—was announced in 2022 to co-produce dog products that are tailored for the outdoor enthusiast pet parent.

For those companies focused on a single segment of the pet sector, it is time to take a strong look inwards. The bigger, multi-platform players will increasingly find advantages through more detailed customer data, financial resources to invest in improved customer experiences, and organic cross-selling channels.

Is your product or service differentiated enough to survive and thrive on its own? If not, are you prepared to take part in the convergence to better serve and know your customer and unlock synergies or is it time to concern an exit strategy before you are left behind?

3. Sub-sector trend: The growth in services and how to pay for them

- With pet owners increasingly treating their pets like extensions of the human family, concern for pet health has given rise to robust growth in veterinary care and other services. Veterinary services revenues have increased from \$40 billion in 2013 to a projected \$62.2 billion in 2023¹² and Credit Suisse estimates that vet care and related product sales revenue would grow at a 9 percent CAGR through 2025.
- Since the start of 2017, veterinary care has accounted for about 40 percent of the corporate M&A deals in the pet sector and 76 percent of private equity deals. PE dealmaking in the veterinary sector has totaled \$45 billion over that same period.¹³
- Beyond veterinary care, other pet services—including grooming, training, and boarding—have grown to close over \$10 billion in 2023.¹⁴
- As consumers increasingly use veterinary services for pet healthcare, concern about paying for the cost of those services has risen. Almost unknown a decade ago, the pet insurance market has grown from \$500 million in 2013 to \$3.2 billion in 2023 and is expected to increase at 8 percent per year over the next five years.¹⁵ Nonetheless, pet insurance penetration is still only 2.48 percent in the U.S., according to industry figures, creating vast potential for growth. The North American Pet Health Insurance Association, a trade group, said in-force premiums were up 30.5 percent in 2021 compared with 2020 and the number of insured pets was over 4.41 million, up by nearly 1 million compared with the year before.¹⁶

¹¹ Source: "Petco Fourth Quarter 2022 Earnings Call," ir.petco.com, March 22, 2023

¹² Source: Ibid.

¹³ Source: "Got a pet? There's a good chance private equity backs your vet," pitchbook.com, September 14, 2022.

¹⁴ Source: "Pet Industry Market Size, Trends & Ownership Statistics," americanpetproducts.org, March 2023

¹⁵ Source: "Veterinary Services in the US - Market Size 2004-2029," IBISWorld, March 2023

¹⁶ Source: "North American Pet Insurance Market More Than Doubles in Four Years," naphia.org, May 16, 2022

Pet companies should evaluate the changing competitive landscape in the pet sector

Pet-focused companies that have yet to join the convergence race, either by diversifying their own portfolio or through strategic partnership, will face a more challenging road ahead. If the strategy is to remain independent without convergence or diversification, competition from companies with a more diverse offering and broader ownership of the customer need across the ecosystem will present increased risk of getting left behind or swallowed up.

For companies at this juncture there are three key steps:

01

Assess market landscape

- First, analyze the strengths and weaknesses of your current position in the market.
- What natural adjacencies are you leaving on the table that might serve to benefit your customers? Are those opportunities better built or bought?
- Do you have the wherewithal to stand pat within your channel, knowing that bigger firms have market power and can command reams of consumer data to tailor their consumer offerings?
- If not, are you a likely acquisition target by bigger companies and how can you ensure you are maximizing your attractiveness and ultimate valuation?

02

Define a differentiated strategy

- Once you have assessed the landscape around you and your current position within it, determine a strategy that maximizes your opportunity to thrive and accelerate growth.
- Should you seek to acquire other businesses, either through vertical integration or horizontal deals? Do you truly understand the segments you might be seeking to enter or are you exposing yourself to risk that requires advance planning and readiness? Do you have the right capital structure in place or can you access additional capital in a tightening credit market?
- Should you seek to restructure your existing business to be more agile and creative in a changing and more challenging market? Do you have the right asset footprint and partnerships in place to maximize efficiency and profitability?

03

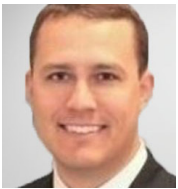
Mobilize your strategy and realize value

- No matter how well designed the strategy, realization of value is ultimately incumbent upon an actionable and accountable plan.
- Companies seeking to grow and expand should be engaging in due diligence on potential acquisition targets to understand commercial opportunities, operational and financial risk, structuring considerations related to debt financing, tax, and deal structure.
- Companies seeking to restructure—whether to focus on differentiation or as a preceding step to potentially exploring an exit—should be proactive in market re-positioning; driving cost takeout and performance improvement opportunities; and focusing on rationalization of their asset base, entity structure, and vendor footprint, all to promote agility.

How KPMG can help

The KPMG Deal Advisory & Strategy Pet Sector team has decades of experience advising companies throughout the pet ecosystem. For companies or sponsors seeking to maximize the value of their current portfolio and the opportunities that lie ahead of them, we bring a wealth of experience across performance improvement, market strategy, pricing and assortment, buy- and sell-side due diligence, and transaction execution and value creation.

Authors



Andrew Lindsay

Principal, Transaction Strategy & Execution

Andrew is a Principal with experience advising Corporate and PE-backed companies across the M&A lifecycle from diligence through post-close transformation, value capture, and restructuring.



Cathy Bedrick

Partner, Deal Advisory

Cathy is a Partner and serves as KPMG's U.S. Financial Due Diligence practice leader as well as the Deal Advisory Pet Sector leader.



Jo Liaw-Hickey

Principal, Deal Advisory

Jo is a Deal Advisory Principal with extensive experience in the pet sector including retail, products, and veterinary services.



Sam Hyman

Director, Transaction Strategy & Execution

Sam is a Deal Advisory & Strategy Director focused on helping clients manage risk and accelerate value creation through complex transactions and organizational transformation initiatives.



Cherian Abraham

Director, Transaction Strategy & Execution

Cherian is a C&R Strategy Director supporting both corporate and private equity clients on complex transactions from pre-sign due diligence through post-close deal execution and transformation.

We would like to thank our contributors:

John Rumbelow and TJ Hoppen

For more information, contact us:

Andrew Lindsay

Principal, Transaction Execution

404-593-5917

ajlindsay@kpmg.com

Cathy Bedrick

Partner, Deal Advisory

312-665-1920

cbedrick@kpmg.com

Jo Liaw-Hickey

Principal, Deal Advisory

415-963-8477

joliawhickey@kpmg.com

Sam Hyman

Director, Transaction Execution

312-665-1924

shyman@kpmg.com

Cherian Abraham

Director, Transaction Execution

214-840-4472

cherianabraham@kpmg.com

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