



HOULIHAN LOKEY

Consumer, Food, and Retail Pet Food and Treat

Considerations for the Pet Food and Treat Industry Amid the COVID-19 Outbreak



Remarks From Tim Larsen, Managing Director of Houlihan Lokey's Consumer, Food & Retail Group

The COVID-19 pandemic has impacted our world, our nation, our economy, and our industry in ways that were unimaginable only months ago. At the time of this writing, nearly 1.5 million confirmed cases of COVID-19 have been identified around the world, the U.S. unemployment rate is estimated to be as high as 13%, and economists are bracing for a decline in national income as deep as 30% in the second quarter of 2020. And while our industry routinely confronts challenges—often serious ones—the challenges of the COVID-19 pandemic make many aspects of how our community typically functions impossible.

The key truth revealed through a pandemic is that every individual is directly part of a system of potential disease transmission, regardless of one's current state of health. And for this reason, social distancing becomes a critical method for slowing the transmission of disease.

For many of us, the Global Pet Expo was the last time we traveled by air or were able to engage in the direct, in-person meetings that are critically important to forming relationships, making deals, and learning about one another's businesses. With our communications now relegated to the online world, these exchanges have become harder, but not impossible.

One bright spot in the face of these challenges and the overall economic crisis is found in the pet food and treat industry, which is currently exhibiting the same recession resistance characteristics it delivered during the last downturn. Indeed, because the pet investment thesis could be expressed in so many words as a treatment for another byproduct of COVID-19, loneliness, the extreme isolation that many are experiencing during social distancing appears to be driving a surge in pet purchases, adoptions, and fostering. And these in turn translate to purchases of pet food. Here is what we are observing:

- The typical avenues of purchase for pet food—retail and, increasingly, e-commerce—remain open and available as the rest of the economy shutters.
- Each of the 41 states that have declared stay-at-home or shelter-in-place orders have deemed animal feed and pet food suppliers to be “essential” industries that will remain operational.
- These trends in concert seem to be contributing to strong performance at points of sale and in financial markets for the pet industry, and our sector is earning its reputation as both a growth category and a safe haven.

In all market environments, Houlihan Lokey specializes in helping clients navigate change and uncertainty. As COVID-19 and the resulting economic consequences continue to evolve, we are closely monitoring the capital markets and working with many companies seeking to strengthen their near- and long-term liquidity positions and overall balance sheets. We bring to bear a broad range of product and service solutions across the capital structure for companies in the pet industry, and our private Capital Markets Group places bespoke debt and equity capital primarily with non-traditional capital providers who remain open for business even in the midst of the current crisis. We stand ready to share our expertise and insight on the unique challenges and opportunities you may be facing.

Sincerely yours,

Tim Larsen

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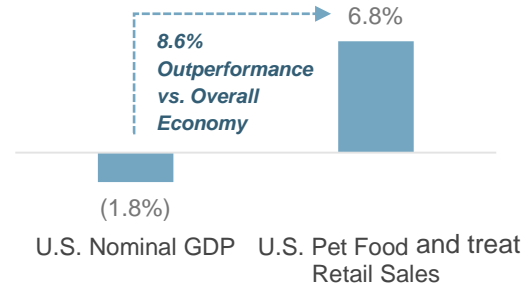
In this special market update, Houlihan Lokey's Food & Beverage practice shares perspectives on trends impacting companies and investors in the pet food and treat industry

The Pet Food Industry Has an Established Track Record of Recession Resistance

- Providing goods that are fundamentally necessary for life, the food and beverage industry is less exposed to macroeconomic volatility than are other sectors.
- As trends such as the humanization of pets grow ever more salient, the market for pet food increasingly exhibits the recession-resilient characteristics of the overall food and beverage industry.
- During the 2008–2009 recession, the pet food and treat industry grew 6.8% as the overall economy declined by 1.8%. Similar performance trends appear to be emerging in the current downturn.

Strong Pet Food and Treat Performance During the Great Recession⁽¹⁾⁽²⁾

(2009 Year-Over-Year Growth)



The COVID-19 Crisis Has Increased, Not Dampened, Pet Food Spending

- Retail purchases of pet food and treats have surged since the onset of the COVID-19 crisis, with weekly year-over-year sales up more than 50%.
- A portion of the increase is attributable to consumers stockpiling pet food as they have other of supplies; however, a large portion of the increase is driven by a dramatic uptick in pet purchases and adoptions as consumers seek to stave off the loneliness caused by social distancing.

In Recent Weeks, Retail Pet Food Purchases Have Surged⁽³⁾

50%+

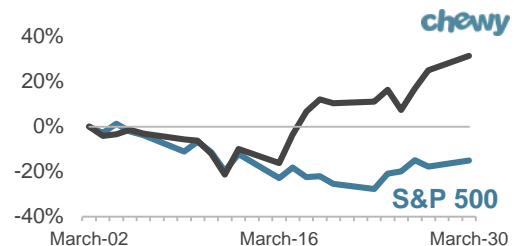
Year-Over-Year Increase in Weekly Dog and Cat Food Sales

Social Distancing Has Accelerated Consumer Migration Toward E-Commerce

- Shelter-in-place orders and a desire to reduce potential exposure to the virus in retail stores have pushed more consumers to online platforms, accelerating trends favoring e-commerce sales of pet food (creating habits that may endure once the crisis abates).
- Chewy, the largest online pet food marketplace, has seen its stock price outperform the broader economy by more than 40% since the beginning of the pandemic.

Chewy's Stock Has Outperformed the S&P500 by More Than 40%⁽⁴⁾

(Price Index, 3/2/2020 = 0%)



(1) Source: Euromonitor. (2) Source: FRED. (3) Source: Nielsen for the week ended 3/20/2020
(4) Source: CapIQ, date ending 3/30/2020.

Considerations for the Pet Food and Treat Industry Amid the COVID-19 Outbreak (cont.)

Primary Drivers of Pet Sector Outperformance During the COVID-19 Crisis

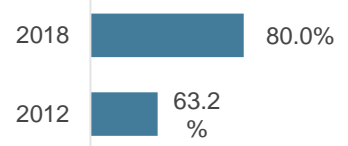
Since the onset of the COVID-19 pandemic, the pet food and treat industry has benefited from pre-existing secular drivers as well as crisis-specific drivers, all of which are contributing toward strong, recession-resistant performance

Humanization of Pets

- Independent of the COVID-19 crisis, the powerful, secular trend of consumers increasingly viewing and treating their pets the same way they do their human children has been widely recognized and broadly commented on.
- This trend forms a strong protective barrier for pet food suppliers, as pet owners are highly unlikely to sacrifice pet food purchases or quality despite the current economic downturn.

Increasing Trend Toward Pet Humanization⁽¹⁾

(Percentage of Pet Owners Who Consider Pets Family Members)

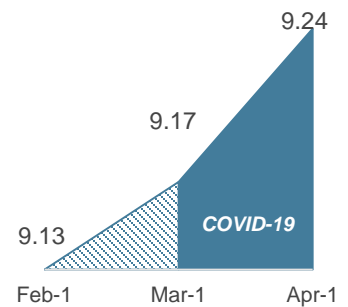


Surge in Pet Adoptions

- The social isolation caused by quarantine has left many consumers looking for ways to combat loneliness and therefore seeking companionship through pets.
- Pet purchases, adoptions, and fostering have all increased dramatically as state- and city-wide shelter-in-place or stay-at-home orders have been introduced.
- The significant uptick in pet ownership driven by quarantine is likely to cause a permanent increase in the need for ongoing pet food purchases, both in the U.S. and globally.

Sharp Acceleration in Pet Adoptions During Social Distancing⁽²⁾

(PetSmart Adoptions, Millions)



Pet Food Suppliers Designated as “Essential” Businesses

- All 41 states that have issued shelter-in-place orders at the time of this writing have deemed pet food companies to be “essential” businesses that should remain operational during quarantine.
- The Department of Homeland Security has also provided guidance on exemptions, which include both pet food manufacturing and grocery channels.

“Food manufacturer employees and their supplier employees—to include... pet and animal feed processing facilities.”

—Department of Homeland Security; March 19, 2020

(1) Source: American Veterinary Medical Association.

(2) Source: PetSmart.

Houlihan Lokey's Global Pet Food and Treat Practice Continues to Gain Momentum

Houlihan Lokey continues to advise key decision-makers in the pet sector during the COVID-19 crisis

Recently Announced Transaction

March 2020



a portfolio company of



has been acquired by




Sellside Advisor

Transaction Overview

- Founded 12 years ago in founder Henrietta Morrison's kitchen in London, Lily's Kitchen has become an internationally recognized retail brand offering natural recipes for dogs and cats across 6,000 stores in 30 countries.
- Lily's Kitchen recently expanded into the Middle East and Asia and already has a growing presence in France, Spain, Italy, the Netherlands, Switzerland, and Germany.
- This acquisition represents another successful pet sector transaction by the Houlihan Lokey Consumer, Food & Retail Group.

Houlihan Lokey's Deep Experience Spans All Areas of the Pet Value Chain

Brands




a portfolio company of

octopus ventures


has sold a majority stake to

Nestlé Purina PetCare


Sellside Advisor



a portfolio company of



has received a significant growth investment from



Financial Advisor & Placement Agent




a portfolio company of

THE CARLYLE GROUP


has been acquired by

Morgan Stanley
CAPITAL PARTNERS

Sellside Advisor



has been acquired by



Sellside Advisor



has entered into a joint venture with



Buyside Advisor

Manufacturing Ingredients



has been acquired by



Sellside Advisor



a portfolio company of




has been acquired by



Sellside Advisor




a portfolio company of




has been acquired by



Sellside Advisor



has been acquired by an affiliate of



Sellside Advisor



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

Company Advisor

How Houlihan Lokey Can Help

Our firm is extremely well equipped to help our clients navigate uncertain times. We respond quickly to challenging situations and are constantly helping clients to analyze, structure, negotiate, and execute the best possible solutions from both a strategic and a financial perspective.

What We Offer

1 Corporate Finance

Mergers and Acquisitions

Capital Markets

Private Funds Group

Board Advisory Services

2 Financial Restructuring

Company Advisory

Special Situations

Distressed M&A

Liability Management

Creditor Advisory

3 Financial and Valuation Advisory

Portfolio Valuation and Fund Advisory

Transaction Opinions

Corporate Valuation Advisory Services

Transaction Advisory Services

Real Estate Valuation and Advisory

Dispute Resolution Consulting

Corporate Finance

We have been the most active advisor to the North American food and beverage industry for more than a decade, and we have long-standing relationships with capital providers, including private equity funds, family offices, commercial banks and other senior credit providers, insurance funds, asset managers, and mezzanine fund investors.

Financial Restructuring

We have the largest special situations practice of any global investment bank. Since 1988, we have advised on more than 1,000 such transactions (with aggregate debt claims in excess of \$2.5 trillion). We served as an advisor on 12 of the largest 15 bankruptcies from 2000 to 2019.

Financial and Valuation Advisory

Over nearly four decades, we have established ourselves as one of the largest financial and valuation advisory firms. Our transaction expertise and leadership in the field of valuation help inspire confidence in the financial executives, boards of directors, special committees, investors, and business owners we serve.

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