



THE DEAL HOUND

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QUARTERLY PET INDUSTRY REPORT

Volume 4, Issue 1, Q1 2013

Pet Industry Deal Activity – Q1 2013

M&A Pet Transactions this past quarter have begun to slow, with only 5 announced transactions. Most deals were strategic acquisitions, in which large companies increase their distribution and offerings by purchasing well-known smaller brands within the industry.

During February, the 2013 Global Pet Expo was hosted in Orlando Florida. The show featured 964 exhibitors, 2,686 booths and more than 3,000 new product launches. With 5,327 pet product buyers from around the world in attendance the show broke records across the board. **We love the pet industry!**

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Pet Deal Activity Highlights

Strategic Acquisitions	March 5, 2013	Phillips Pet Food & Supplies , a distributor based in Easton, Pa. acquired competitor, Royal Pet Supplies , distributors of aquatics equipment and supplies.
	March 3, 2013	Animal nutrition company Manna Pro purchased the Start to Finish Equine Treats and Supplements and Advance Small Pack product line from Milk Specialties Global .
	February 8, 2013	Radio Systems Corp. , the manufacturer of PetSafe, has acquired Pup-Pee Solutions , makers of the Pet Loo artificial lawn potty platform and other indoor waste-management products.
	February 1, 2013	Perrigo Co. , extended its involvement in the pet health care market industry by acquiring Velcera Inc. , maker of PetArmor for \$160 million in cash.
Financial Deals	January 11, 2013	Wafra Partners LLC , a private equity firm, acquires Phelps Industries, LLC , a manufacturer and marketer of pet treats and chews.

Q1 2013 Pet M&A Activities



Sniffing Out a Deal – Perrigo Co.



Acquisition Type:
Strategic

Value Drivers:
*Access into Growing Market
Leveraged Distribution Channels*

The Perrigo Company is a leading global healthcare supplier that develops, manufactures and distributes over-the-counter (OTC) and prescription pharmaceuticals, nutritional products, active pharmaceutical ingredients (API) and consumer products.

Perrigo has been increasing its offerings within Pet sector, focusing on the emerging OTC companion animal healthcare market. Last year the company purchased all of Sergeant's assets, and now is set to acquire Velcera in 2013.

Velcera is a leading companion pet health product company committed to providing consumers with best-in-class pet health products that contain the same active ingredients as branded veterinary products, but at a significantly lower cost. Velcera, together with major retail partners, has been instrumental in developing an OTC market for pet health products traditionally dispensed only by veterinarians.



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Scott Sellers
Encore Consumer Capital

Scott co-founded Encore Consumer Capital in 2005. Encore Consumer Capital is a consumer products focused private equity firm based in San Francisco with \$375 million under management. Scott's area of focus includes the pet sector and food companies. Scott is Chairman of Encore's pet industry portfolio companies Zuke's and Thundershirt.

Prior to Encore, Scott was a partner at the private equity firm Swander Pace Capital, where he served as a Director of numerous consumer companies including Eagle Pack Pet Food. Scott's experience in the consumer products industry also includes Swander Pace & Company where he advised consumer products companies and retailers on matters of corporate strategy, category management and competitive assessment.

Scott received a BS with distinction and an MS in Industrial Engineering from Stanford University.

Spotlight

Investment Perspective: with Scott Sellers, Co-founder & Managing Director of Encore Consumer Capital
An Interview with SDR's Carol Frank

1. Why do you think there has been so much interest in the pet industry from Private Equity Groups?

Private Equity Groups are looking for growth sectors, and the pet industry has great demographic trends behind it with a consistent track record of growth across different economic cycles. There was an uptick in private equity interest in the industry in 2007 when pet food contaminated with melamine from China was recalled. This marked an inflection point for the natural, organic and made in the USA food and treat brands, as they were the beneficiaries of consumers doing more diligence on what they feed their pets. Many private equity groups that are attracted by these trends will kick the tires in the industry and hire a business broker or junior resource to reach out to companies, but they don't necessarily understand the industry and they often struggle to find opportunities that fit their size criteria and often abandon their search without making an investment in the industry.

2. What pet companies do you have in your portfolio? What was appealing to you about those particular investments?

We have investments in Zuke's, a leading natural pet treat brand, and Thunderworks, maker of the Thundershirt and other pet anxiety solutions. We were attracted by the strength of the brands at each company and their growth potential. Also, each company offered the opportunity to partner with a talented management team that was looking for partial liquidity and the ability to stay involved in taking the company to the next level with Encore.

3. What are the advantages of selling to a private equity firm versus a strategic?

Selling to a strategic usually means selling out completely and your organization will likely be absorbed by the acquirer. Your employees may or may not be retained after the transaction. Selling to a private equity firm can enable you to take some money off the table, but continue to run your

company and grow it to the next level where you and your employees can continue to benefit from its future success.

4. Often owners will sell a portion of their business to a PE group, known as "taking the first bit of the apple." What should an operator expect to be different once they take that bite and sell to a PE group such as Encore?

When selling to a private equity group, there will be a level of accountability and reporting that you may not have had previously. If the relationship with the PE firm is one of mutual trust, it can be a rewarding relationship where the extra set of eyes on the business from the PE firm will bring new value added insights to help you make your company even better. If there isn't mutual trust, the accountability and reporting will feel burdensome. It is important to choose a partner who can help you grow your business and that you will enjoy sitting with in a board meeting. In addition, if you have taken some money off the table, and perhaps have some cash on the balance sheet, you are more likely to invest aggressively to grow your business.

5. What can a pet product manufacturer do to make themselves attractive to a private equity firm like Encore?

Be the best at what you do and don't spread yourself too thin. The barriers to entry in the pet industry are almost non-existent, so we would rather invest in a \$20 million brand that is Number One in its segment of the pet industry rather than a \$40 million company that is spread across many segments with low market share in each segment. Private equity firms look to triple the value of their investment over time so there needs to be a clear opportunity to grow the company to that level.

6. What's next for Encore in terms of pet industry investments?

Our goal is to build upon our track record of being great partners with pet industry entrepreneurs in helping them accelerate the growth of their companies. We recently raised a new fund and expect to make multiple additional investments in the pet industry targeting high growth companies. We look at companies in the pet food, pet treats, and pet supplies segments both branded and private label. We do not invest in retailers or service businesses.



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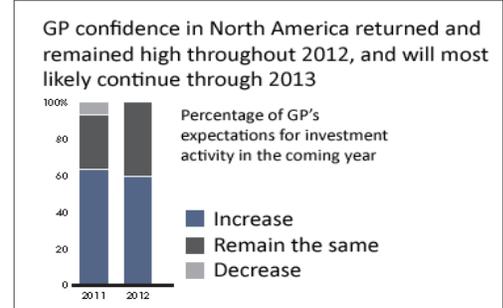
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M&A Market Overview

PRIVATE EQUITY INDUSTRY OUTLOOK

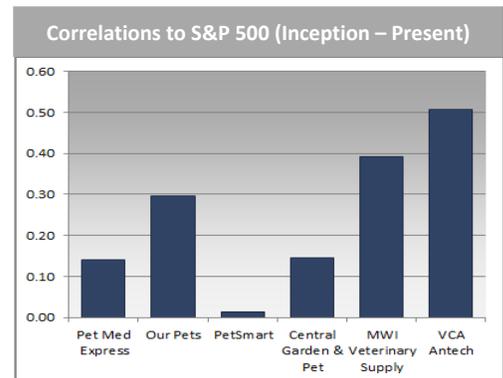
2012 was a flat year, according to Bain & Company's Global Private Equity Report, which means the private equity industry is facing increased competition in 2013. However, the industry is also poised to capitalize on robust debt markets, a resurgence of corporate M&A activity and support of institutional investors. As North America's confidence in the economic recovery rises, equity markets and debt markets increase, showing positive signs for PE deal making. These factors also bode well for pet companies who desire to sell to private equity.



PUBLIC PET BASKET VS S&P 500

Pet companies are known to be resilient to market conditions and offer lower risk for investors. A way to measure the risk of pet companies is their correlation to the S&P 500. Correlation is a measure of how associated stock prices are to the overall market.

The closer to 1 each company's correlation is, the more like the S&P 500 it has performed. As the graph shows, the average correlation between public pet companies and the S&P 500 is 0.25. Put simply, on average if the market decreases 1% then a public company would decrease only 0.25%. Therefore, in a market downturn or upturn, the average pet company will not be as affected.

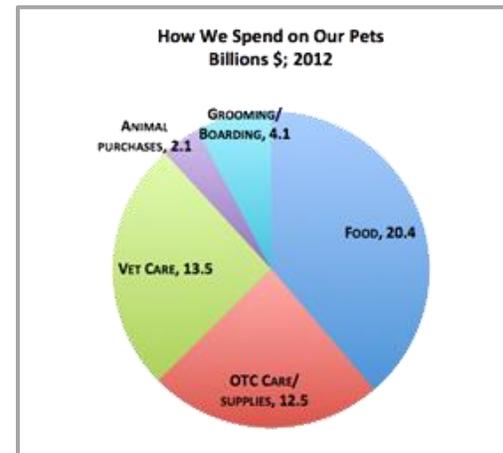


In the news

IS OBAMA CARE AFFECTING THE COST OF PET HEALTH CARE?

The veterinary industry is on the rise, with Americans spending over \$50 billion dollars last year – the majority of expenses going to healthcare expenses (see chart to the left). And the costs of pet health care look like they are only going to increase over the next year as The Patient Protection and Affordable Care Act (better known as Obama Care) starts to take effect.

A new 2.3% federal excise tax on certain medical devices is to blame for the increase in costs. Medical devices used only on animals are exempt. However, items including IV pumps, sterile scalpels and anesthesia equipment, which are medical devices that can be used on people and animals, will be taxed. The device tax is expected to raise costs for consumers. A [recent survey](#) of 181 manufacturers found that 52.5% plan to "pass along some or all of the increased cost [of the tax] to consumers." And while it seems to be an unintended cost increase for pet owners, it is something we all should be aware of for in 2013.



Data Sources: 2013 Bain & Company's Global Private Equity Report
 Emergo Group: 2012 Medical Device Industry Survey
 CapitalIQ



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SDR Ventures: The Investment Bank to the Pet Industry

Carol Frank (cfrank@sdrventures.com), Managing Director



Prior to joining SDR Ventures in 2009, Carol developed three multi-million dollar pet companies in retail, manufacturing, and distribution. She successfully built and sold all three companies, and possesses the rare combination of investment banking expertise and transactional experience in the pet industry.

Carol began her career as a CPA with Ernst & Young and also spent three years as an executive recruiter for Robert Half International. She has a BBA in accounting from The University of Texas at Austin and an MBA from Southern Methodist University. Carol is a former board member of PIDA, PIJAC and The Pet Care Trust. She also holds a Series 79 license, as a registered investment banker.

SDR Core Services

Transaction Advisory

Pet Industry Sell-Side

As former owners and operators, our principals have experienced the M&A world from the trenches. As investment bankers, our principals have gained the experience necessary to maximize value and facilitate a successful transaction. We know how to run an efficient and effective process, how to avoid pitfalls, how to maximize shareholder value, and how to minimize operational distractions.

Capital Formation

Principal

In 2008 we established a dedicated fund, committed to providing liquidity to privately held companies. To-date we have funded 37 subordinated debt deals and invested a total of over \$40.8 million.

Strategic Advisory

Unlike traditional investment banks, SDR views each client as a relationship rather than a transaction. Our passion is helping business owners maximize value in their business. While this often takes the form of advising on acquisitions, sales, and recapitalizations, we realize that not every business is ready for such a transaction.

Our advisory services are designed to add value. Advisory engagements include (but are not limited to):

- Company Valuation
- Capital Strategy
- Exit Planning
- Shareholder Strategy

Pet Industry Buy-Side

Whether growing your company organically with a well-planned acquisition strategy or initiating an executive search to find the right company to buy and operate, our proprietary buy-side search process has proven extremely effective at generating responses, identifying "off-the-radar" opportunities, negotiating favorable deal terms and closing transactions in a timely manner.

“SDR can be your outsourced Mergers & Acquisitions team.”

Placement Agent

In the event that our debt solutions are not a fit for your strategic goals, SDR will act as a finder for debt and equity capital. Our goal is to identify the right capital and the right capital provider based on your needs.

Recent Transactions

<p>November 2012 Transaction Advisory Buy Side</p> <p>Western Paper Distributors Western Paper Distributors, Inc.</p> <p>Has Acquired</p> <p>High Quality Commercial Properties, Inc. The underlying asset is a commercial building located in Denver, CO.</p> <p>SDR Ventures</p>	<p>August 2012 Capital Formation Principal</p> <p>Debt Financing Provided to</p> <p>Jonea Homes, Inc.</p> <p>Financing Provided by</p> <p>SDR Ventures</p>	<p>June 2012 Transaction Advisory Sell Side</p> <p>All Local Fulfillment</p> <p>Has been acquired by</p> <p>The underlying asset is an exclusive retailer for digital fulfillment.</p> <p>SDR Ventures</p>	<p>May 2012 Transaction Advisory Buy Side</p> <p>Mountain Tech</p> <p>Has been acquired by</p> <p>Cohio Ventures LLC</p> <p>The underlying asset is an exclusive advisor to Cohio Ventures LLC.</p> <p>SDR Ventures</p>	<p>April 2012 Preferred Equity Financing</p> <p>SecurCare Self Storage</p> <p>SecurCare Oklahoma A+ Portfolio, LLC</p> <p>Equity provided by Private Investors</p> <p>The underlying asset is an exclusive advisor to SecurCare Self Storage, Inc.</p> <p>SDR Ventures</p>
<p>March 2012 \$5,000,000 Senior Debt Financing</p> <p>Provided to</p> <p>DENNEY</p> <p>Genney Transport, LTD</p> <p>Member of Omaha Bank</p> <p>SDR Ventures</p>	<p>February 2012</p> <p>Sticky Science</p> <p>Has been acquired in a stock sale by</p> <p>Ponder Pet</p> <p>Revenue Pet Products, LLC</p> <p>SDR Ventures</p>	<p>January 2012</p> <p>HEALTHTRANS</p> <p>Has been acquired by</p> <p>SXC Health Services Corp.</p> <p>The underlying asset is a medical facility in Austin, TX.</p> <p>SDR Ventures</p>	<p>January 2012</p> <p>SOUTHWESTERN</p> <p>Providence Apartments 4th & 16th Apartments</p> <p>Providence Apartments 4th & 16th Apartments, LLC</p> <p>Willow Land Company, LLC</p> <p>The underlying asset is a commercial building in Denver, CO.</p> <p>SDR Ventures</p>	<p>October 2012</p> <p>SecurCare Self Storage</p> <p>SecurCare Oklahoma A+ Portfolio, LLC</p> <p>Equity provided by Private Investors</p> <p>The underlying asset is an exclusive advisor to SecurCare Self Storage, Inc.</p> <p>SDR Ventures</p>