



# THE DEAL HOUND

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## QUARTERLY PET INDUSTRY REPORT

Volume 3, Issue 3, Q3 2012

### Pet Industry Deal Activity – Q3 2012

In the third quarter Pet Industry M&A activity has slowed down, with only 5 announced transactions. However, these transactions still made an impact on the industry with 40% of deals exceeding \$50 million.

September was a busy month with the SuperZoo trade show taking place in Las Vegas, NV. This year's show hosted 871 exhibiting companies, including 254 first-time exhibitors; attendance also increased 12% over the 2011 event.

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#### *Pet Deal Activity Highlights*

	July 11, 2012	<b>K9 Bytes</b> , a developer of kennel software solutions for the pet care industry, has been acquired by <b>Epazz, Inc.</b> , a cloud-based software solutions company.
	August 21, 2012	<b>For the Earth</b> acquired <b>Prestige Pet Products</b> . Prestige Pet Products manufactures all natural pork and rawhide chews for pets.
Strategic Acquisitions	September 13, 2012	<b>Perrigo Company</b> acquired <b>Sergeant's</b> assets at \$285 Million. Sergeant is a privately-held, Omaha, Nebraska-based manufacturer of OTC companion animal healthcare products.
	September 14, 2012	<b>Bayer Healthcare</b> , announced that it will acquire the animal health business of <b>Teva Pharmaceuticals</b> . Expected to close next year, Bayer will make an upfront payment of \$60 million and milestone payments up to \$85 million linked to the successful and timely manufacturing of sales targets.
	September 28, 2012	<b>Phillips Feed &amp; Pet Supply</b> has acquired <b>K&amp;W Distribution Co., Inc.</b> Phillips Feed & Pet Supply is a family owned full-line distributor offering over 250 brands.

Financial Deals	July 12, 2012	<b>AgrolInvest</b> and <b>India Invest</b> invested in 19 million euros (\$23.4 Million USD) to acquire joint stake in the merger of <b>Continental Nutrition</b> and <b>Villeneuve Petfood</b> . Continental Nutrition is a French based company that produces and supplies wet & dry foods and snacks for dogs and cats.
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#### Q3 2012 Pet M&A Activities

6 Total Transactions

5 Acquisition Deals

1 Growth Capital Deal

#### *Sniffing Out a Deal – The Perrigo Company*

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 is looking to increase its current offerings, and with Pet Care being an \$8 billion industry that has shown consistent growth through economic cycles, the company decided to purchase Sergeant's assets.

Pursuant to the terms of the agreement, Perrigo will acquire substantially all of the assets of Sergeant's for \$285 million in cash on a debt free basis. Perrigo intends to fund the transaction using cash on hand.

Perrigo expects to receive a significant tax benefit generated from the amortization of the step-up in tax basis resulting from the acquisition of Sergeant's assets. This increase in basis is expected to result in cash tax savings to Perrigo over the next 15 years. The estimated net present value of these savings is approximately \$50 million.

September 13, 2012  
\$285 Million

**Sergeant's**

Assets have been acquired by

**Perrigo**

**Acquisition Type:**  
*Strategic*

**Top 5 Value Drivers:**  
*Avoid High Barrier to Entry  
Add New Product Line  
Access into Growing Market  
Leveraged Distribution Channels  
Increase tax Cash Savings*



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### Global Opportunities Abound for the Right Products & Services

*2012 Colorado CEO Forum: What in the World is Going On?*

An article by SDR's Carol Frank

For the last 6 years, SDR Ventures has sponsored the Colorado CEO Forum, an annual gathering for CEOs of companies with \$5 million to \$200 million in revenue. The Forum always features a fascinating speaker, and this year's, Herb Meyer, was certainly no exception.

Herb Meyer served as Special Assistant to the Director of the CIA and Vice Chairman of the CIA's National Intelligence Council during the Reagan Administration. He is widely credited as the first senior official to predict the collapse of the Soviet Union – a forecast for which he later was awarded the U.S. National Intelligence Distinguished Service Medal, which is the Intelligence Community's highest honor. Meyer is also the host and producer of **The Siege of Western Civilization**, a DVD outlining the threats to our security, our economy and our culture that became an international best seller.

Meyer's speech entitled "What in the World is Going On," provided an intelligence briefing to the CEOs focusing on the major topics described below:

#### EMERGENCE OF A GLOBAL MIDDLE CLASS.

An economic shift is beginning to occur; people all over the world are crossing over the poverty line, creating a large and expanding middle class. With the increase in the middle class comes an increase in disposable income, creating growing demands for products and services to address this emerging demographic. An example of this: IKEA is manufacturing houses that people can take home and build themselves for a fraction of the cost of a regular house. Other fast growth industries that will cater to this group are:

- **Construction** - as more and more people can afford to purchase homes
- **Infrastructure** – the construction of new homes will demand it
- **Energy** – consumption will increase as billions of people come out of poverty
- **Healthcare** – our population is aging rapidly
- **Education** – as more families can afford to have their children enroll in school
- **Entertainment** – people will have more disposable income.

An encouraging effect from this emerging middle class is the decreased frequency of war. As explained by Meyer, middle class people do not go to war with other middle class people. They prefer to discuss their disputes rather than fight.

#### PLUNGING BIRTHRATES WILL LEAD TO NUMEROUS CHALLENGES.

A major measurement that was focused on was that to sustain a population the required birthrate is 2.1 per woman. Meyer provided numerous statistics concerning low birthrates in first world countries and how it will ultimately affect the world:

- Europe's overall birthrate is 1.5. Germany is only at 1.3 and 40% of German women are childless. Even more shocking, 17 European countries have birthrates below 1.3! In 30 years, Europe will have 80 million **fewer** people than today.
- Japan's birthrate is 1.3. Meyer explained that instead of trying to increase the birthrate, they have resorted to closing schools and cutting back on services. At this rate, by 2020 the country will essentially shut down.
- By 2050, the population of Russia, currently 139 million people, will be smaller than the population of Yemen, currently 24 million people.
- China's "one baby per household" policy has resulted in a population that is plummeting and a workforce that is shrinking. There is a looming crisis. By 2020, 250 million Chinese will be over 65, and unable to work.
- By 2045, the number of humans over 55 will be larger than the number under 15. As the population ages, healthcare costs will skyrocket.

**US birthrates are so low that in Seattle, dogs outnumber children.**

#### OPPORTUNITIES.

- Creating products and services for the upcoming Global Middle Class. Meyer says that fortunes are being made by companies who produce products that are clever, inexpensive, and green. Think housing, cars, energy, and consumer goods.
- Products and services that care for the aging, affluent customer.

I've seen plenty of products that cater to the senior pet. **But what about products which cater to the senior pet owner?** I have always thought there is tremendous opportunity in producing products for the pet owning senior citizen who just isn't as strong and agile as they used to be but still wants to take great care of their feathered or furry loved one. **I'd love to hear from those of you that have products in this category!** The right products will be huge hits for many years to come.



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### Capital Market Analysis

#### Case Study

The owner of Canine Adventures\* sold his company in 2011, but wanted to know what his total proceeds would have been had he waited until 2013.

The capital gains taxes are expected to increase from 15% to 23.8% starting January 1, 2013.\*\* In the example to the right the data is adjusted to show the difference in the tax effect.

With revenue and other variables staying the same, the owner of Canine Adventures collected \$1,848,000 more than if he had waited to sell his business in 2013 due to the change in capital gains taxes.

	2011	2013
Revenue	\$20,000,000	\$20,000,000
EBITDA (15% Revenue)	\$3,000,000	\$3,000,000
Valuation Multiple	7x EBITDA	7x EBITDA
Gross Sale Price	\$21,000,000	\$21,000,000
80% Cash Sale	\$16,800,000	\$16,800,000
<Taxes Paid>	(\$2,529,000)	(\$3,998,400)
Total Proceeds @ Close	\$14,280,000	\$12,801,600
20% Escrow (after 12 months)	\$4,200,000	\$4,200,000
<Taxes Paid>	(\$630,000)	(\$999,600)
<b>Net Proceeds after 12 Months</b>	<b>\$17,850,000</b>	<b>\$16,002,000</b>

\* Canine Adventures is only an example company to display the capital gains tax effect.

\*\* Includes a 3.8% unearned investment income tax.

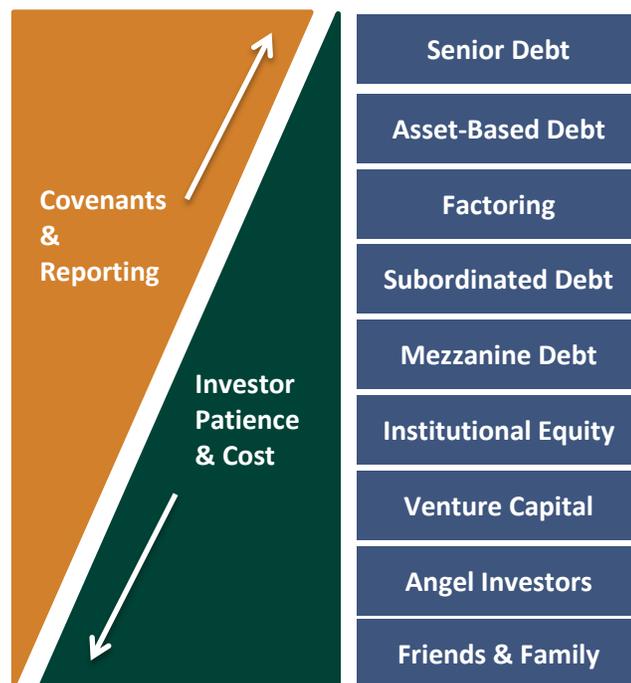
#### What is the cost of capital?

If you are looking for capital, it is important to know what it will cost you. According to the Pepperdine Capital Markets project, the cost of capital varies greatly depending on the capital provider, the size of the business and the assumed risk. The chart below reveals that banks have the lowest rates, but require the strictest covenants and reporting, while capital obtained from angels is patient but could cost significant equity.

Average annualized gross financing costs for each major capital type and segment.

	1st Quartile	Median	3rd Quartile
Asset Based Lending	3.5%	5.7%	6.7%
Bank Loans	5.2%	5.7%	6.3%
Mezz Debt	18.2%	19.5%	20.8%
Private Equity	23.3%	28.2%	36.4%
Venture Capital	22.0%	32.3%	55.5%
Angel Investment	26.0%	42.0%	73.8%

Source: 2011 - 2012 Pepperdine Private Capital Markets Project





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### SDR Ventures: The Investment Bank to the Pet Industry

**Carol Frank** ([cfrank@sdrventures.com](mailto:cfrank@sdrventures.com)), Managing Director



Carol has 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 also 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 buy-side search process has proven extremely effective at generating responses, identifying "off-the-radar" opportunities, negotiating favorable deal terms and closing deals 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>August 2012 <b>Capital Formation</b> Principal</p> <p>Debt Financing Provided to:</p> <p>Financing Provided by: <b>SDR Ventures</b></p>	<p>June 2012 <b>Transaction Advisory</b> Sell Side</p> <p>ALL-Just Fulfillment</p> <p>Has been acquired by:</p> <p>The undersigned served as exclusive advisor to All-Just Fulfillment</p> <p>SDR Ventures</p>	<p>May 2012 <b>Transaction Advisory</b> Buy Side</p> <p>Mountain Tech</p> <p>Has been acquired by:</p> <p>The undersigned served as exclusive advisor to Mountain Tech</p> <p>SDR Ventures</p>	<p>April 2012 <b>Preferred Equity Financing</b></p> <p>Provided to:</p> <p>SecurCare Oklahoma A- Portfolio, LLC</p> <p>Equity provided by Private Investors</p> <p>The undersigned served as exclusive advisor to SecurCare Self Storage, Inc.</p> <p>SDR Ventures</p>	<p>March 2012 <b>\$5,000,000</b> Senior Debt Financing</p> <p>Provided to:</p> <p>Mutual of Omaha Bank</p> <p>The undersigned served as exclusive advisor to Mutual of Omaha Bank</p> <p>SDR Ventures</p>
<p>February 2012</p> <p>Sticky Pet, Inc. 45.5% Stake Plan</p> <p>Has been acquired in a stock sale by:</p> <p>SDR Ventures</p>	<p>January 2012</p> <p>HEALTHTRANS</p> <p>Has been acquired by:</p> <p>The undersigned served as exclusive advisor to HEALTHTRANS, Inc. and SXC Health</p> <p>SDR Ventures</p>	<p>January 2012</p> <p>SOUTHWESTERN</p> <p>Has been acquired by:</p> <p>The undersigned served as exclusive advisor to SOUTHWESTERN</p> <p>SDR Ventures</p>	<p>December 2011</p> <p>Mowbar Investments LLC</p> <p>Equity Placement</p> <p>Financing provided by:</p> <p>SDR Ventures</p>	