



THE DEAL HOUND

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QUARTERLY PET INDUSTRY REPORT

Volume 4, Issue 3, Q3 2013

Pet Industry Deal Activity – Q3 2013

Pet Industry M&A activity has slowed down slightly in Q3 2013, with 7 transactions announced compared to 10 in the second quarter. Strategic acquisitions continue to dominate deal activity within the industry, with a particular focus on distribution services. Major players like Animal Supply Co. and Pet food Experts have increased their distribution territories through acquisitions in the past quarter.

Following the trends of the first half of the year, Q3 had numerous mergers and acquisitions involving strategic industry insiders looking to grow through acquisition. We expect this trend to continue throughout the rest of the year.

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Pet Deal Activity Highlights

Strategic Acquisitions	July 1, 2013	The Kyjen Company , a designer and distributor of branded dog toys, was acquired by private equity firm The Riverside Company for an undisclosed amount.
	July 16, 2013	Animal Supply Co. , a Seattle-based pet product distributor, acquired Southern California competitor Pet Food Wholesale Inc. for an undisclosed amount.
	September 6, 2013	Pet Food Experts, Inc. , a distributor of premium pet foods and pet supplies, acquired the assets of Zeus & Company's Midwest Operations , a distributor of pet food and pet products.
	September 23, 2013	Animal Supply Co. , announced it has planned to merge with RFG Distributing, Inc. to serve 40 states and pet stores.
Financial Deals	June 5, 2013	Brad's Raw Foods, LLC received \$100,000 in growth capital from investors including Ben Franklin Technology Partners of Southeastern Pennsylvania and Investment Arm . Brad's Raw Foods makes Brad's Raw 4 Paws dog treats.
	July 30, 2013	Rover.com , a digital home dog boarding company that connects dog owners with approved and reviewed dog sitters, received \$3,500,000 in new funding, led by specialty retailer Petco .
	September 26, 2013	Petsmart announced it is increasing its dividend by 18% and is buying back \$535 million of its outstanding shares.

Q3 2013 Pet M&A Activities

7 Total Transactions

4 Acquisition Deals

3 Financial Announcements

Sniffing Out a Deal – Pet Food Experts



Acquisition Type:
Strategic

Top 5 Value Drivers:
*Increasing Pet Portfolio
Successful Brands
Robust Growth Opportunities
Supply Chain Innovation
Strong Distribution Relationships*

Pet Food Experts, headquartered in Cumberland, Rhode Island, was founded in 1936 by the Baker Family. Today the company is still operated by the Baker family, which distributes premium pet foods and pet supplies throughout New England, New York and the Mid-Atlantic.

The company purchased the assets of Zeus & Company, a distributor of pet food and cutting-edge pet products in the greater Chicago area, southern Minnesota, Wisconsin and northern Indiana.

The acquisition adds synergies to Pet Food Experts' scale and brings valued brands like Blue Buffalo to all of the regions it serves. Pet Food Experts will now serve retailers located in Illinois, Wisconsin, Minnesota, North Dakota, South Dakota, Nebraska, Iowa, Indiana and Missouri in addition to its current territory on the East Coast. SDR served as Buy Side Advisor to Pet Food Experts.



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Spotlight

Deal Perspective: Jim Alden, CFO of Pet Food Experts, Inc.
An Interview with SDR's Carol Frank

Please give us a brief history of Pet Food Experts

Pet Food Experts, Inc. (PFX) was started in 1989 by George K. Baker as an exclusive lams distributor in Southeastern New England. Michael Baker bought the Company in 2005 from his father. Through acquisitions and territory expansions, the Company now operates in 21 States.

1. You recently purchased a distributor located in the Midwest (Zeus & Co.). What was the impetus behind that transaction?

We have been looking for the right opportunity to acquire a pet food distributor contiguous to our established footprint for several years but were not able to consummate a transaction. When we were approached by you about the potential deal, we thought it would be a long-shot due to the non-contiguous challenges. As we did our due diligence, we quickly realized the Midwest market appeared ready for consolidation as it had many regional players, yet was the only territory in the US in which neither of the major PE-owned distributors operated.

2. How do synergies play into the way you evaluate acquisitions?

In terms of pure financial synergies, we are eliminating very few positions and for the most part will replace them in RI on a one-for-one basis. We decided after making an acquisition in Springfield, MA (where we closed the warehouse and eliminated 60 jobs) that we were not going to make an acquisition in order to eliminate competition – it's a poor use of funds and is detrimental to our independent retail customers. On the other hand, we have a wonderful relationship with many top pet food and supply vendors that are anxious to expand with us. Those deep relationships and the potential to offer Zeus customers an expanded brand portfolio played into our decision. Additionally, the potential of Private Equity-backed distributors entering the market via acquisitions led to our decision to put ourselves in the right position to succeed long-term. Synergies or not, it's still imperative that we execute and deliver our family-style of operational excellence and sales and marketing support.

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

It has proven to be recession resistant and has had steady growth for the past decade specifically in the pet food distribution space. The space is fragmented with many aging shareholders with no clear succession plan, so the roll-up play is very appealing to private equity.

4. What is the largest change the industry has undergone since you began working in it 10 years ago?

In pet food distribution, it has been the change from exclusive territory rights and limited competition to a more free market. When I started, each territory across the US tended to have a distributor

that carried lams, another that carried Nutro and a third or fourth that carried Nestle, Wellness or Natura and they tended to stay in their back yard and compete just on a few ancillary products. Everyone got along, made money and nobody outside the industry paid much attention. When lams allowed its distributors to carry competing brands, PFX was one of the first to grab competitors' vendors and expand outside its lams territory into NY. This was considered unbecoming at the time and did not make PFX very popular with other distributors – particularly the ones that were impacted. I received a call from a distributor at the time (now out of business) who said we were "stealing his brands from behind his back". Needless to say, times have changed.

5. What does Pet Food Experts look for when deciding whether to distribute a new line of pet products?

First and foremost, is the product compelling? We include folks from sales, marketing, and purchasing (many of which have retail pet experience) in our new product committee. We look for something that is unique and not another "me-too." We prefer exclusive arrangements depending on the life cycle of the product. If it's a launch with no existing business, exclusivity is a must, but if it has existing sales and field sales representative, it's less of an issue. We strongly favor products we can carry in our entire footprint. Lastly, gross profit per unit/pound and market potential also weigh into the decision. There are many products and entrepreneurs we really like, but these other factors prevent PFX from distributing it.

6. What advice would you give to the small or mid-sized pet product distributor or manufacturer in terms of maximizing the value of their business?

For a distributor – do something special to add value in the supply chain; don't just "ride" a special brand. So many small distributors are part retailers that asked for exclusive rights to a hot pet food that they thought someday would be successful (Natura, Champion, etc.). Exclusivity and vendor loyalty alone doesn't make a business, and that loyalty between supplier and distributor is most likely non-transferrable. Distributors that have built deep relationships with customers engender value. We have turned down acquisitions that were just about picking up vendor contracts.

7. What are some of the biggest lessons you have learned since you began working at PFX as CFO?

Don't send an email when a phone call is required. Don't make a phone call when a personal visit is required. Most importantly – don't ask of someone something that you wouldn't agree to if you were in their position. I have worked hard not to simply be known as the PFX bad cop – I learned some good lessons about building relationships and finding compromise. Not easy as a former Investment Banker!

8. What's next for Pet Food Experts?

We will continue to build critical mass in the Mid-Atlantic and Midwest markets and remain focused on the simple things that have brought us success: happy customers, vendors and employees!



Jim Alden
CFO, Pet Food Experts

Mr. Alden joined PFX in 2004, assisting the Baker family in a generational transition. Now serving as CFO, Mr. Alden currently oversees the Accounting, HR and MIS departments and is responsible for driving corporate strategy & business development for the Company.

Mr. Alden's background includes Investment Banking, Corporate development and FP&A. He earned a Bachelor of Science from Babson College in Finance.



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M&A Market Overview

DEAL ACTIVITY

Animal Supply Co. has been very active in the mergers and acquisitions market over the past year. It has completed five strategic acquisitions including Southern California competitor Pet Food Wholesale Inc.; Wholesome Pet Distributing of Orrville, Ohio; Summit Pet Product Distributors of Greensboro, N.C.; Lone Star Pet Supply of Schertz, Texas; and Zeus & Co. California (West). Additionally, Animal Supply recently announced a sixth transaction, a merger with RFG Distributing, Inc. Animal Supply isn't the only distributor increasing its territories, as both Pet Food Experts and Phillips Pet Food & Supplies have been actively acquiring pet distribution companies this year.

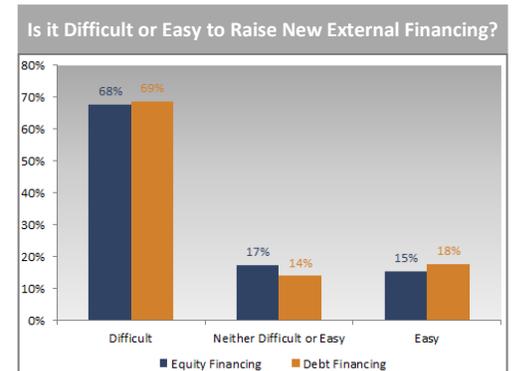
Phillips Pet Food & Supplies recently announced that they are for sale. Upon further investigation, SDR discovered that Blaine Phillips and Fred Schober, the major shareholders, will be staying on to run the company. In lieu of a 100% sale, AEA, Phillips' private-equity partner, is looking to either exit their investment completely or bring in a larger PE group to help execute Phillips's fast-growth strategic plan over the coming years.



ACCESS TO CAPITAL STILL A CONCERN

The Summer 2013 Pepperdine Capital Markets Study found that accessing capital was difficult for many companies, with 68% of respondents stating that in the current business environment, it is difficult to raise new business financing. In fact, only 33% of businesses were successful in securing a bank loan, which is an alarmingly low application-to-loan ratio.

Moreover, 65% of respondents expect it to remain difficult to raise new financing in the next 6 months (compared to 20% that expect it to be easy).

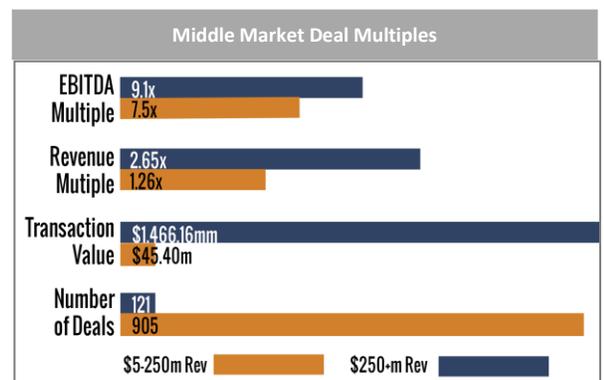


MIDDLE MARKET DEAL MULTIPLES

The middle market (companies with \$5 - \$250 million in revenue) has seen an increase in transaction volume over the past year. In the third quarter alone, there were a total of 905 deals closed. These deals averaged a total transaction value of \$45.4 million. EBITDA multiples in the middle market average about 7.5x.

Companies with revenues of over \$250 million had only 121 transactions in the past quarter. While EBITDA multiples are higher for large companies (9.1x), higher transaction volume in the middle market means it will be a more attractive space for M&A transactions.

Shifting focus to the pet industry, public pet companies trade for larger average EBITDA multiples of 12.1x, meaning these companies are typically valued higher than their privately held counterparts. We can expect to see private pet companies continue to transact within the 6x-9x EBITDA range.



Sources:
 Pepperdine Private Capital Markets, Second Quarter Private Capital Access Report
 PitchBook, 3Q 2013 Deal Multiples & Trends Report
 S&P 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 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>September 2013 Transaction Advisory Buy Side</p> <p>FOOD EXPERTS Has acquired the assets of Zeus Pet Company Has and compares the trade businesses, its... The undersigned served as exclusive advisor to the Food Experts, Inc. SDR Ventures</p>	<p>September 2013 Capital Formation</p> <p>Debt Financing provided to condit CONDIT, LLC The undersigned served as exclusive advisor to Condit Holdings, LLC SDR Ventures</p>	<p>September 2013 Capital Formation</p> <p>HALKER Halter Consulting, LLC Debt Financing provided by Colorado Business Bank Colorado Business Bank The undersigned served as exclusive advisor to Halter Consulting, LLC. SDR Ventures</p>	<p>May 2013 Transaction Advisory Buy Side</p> <p>SECUREPLACE SECUREPLACE, INC. LLC Formerly known as Western Storage Has been acquired by Private Investors The undersigned served as exclusive advisor to SECUREPLACE SDR Ventures</p>	<p>November 2012 Transaction Advisory Buy Side</p> <p>Western Paper Distributors Western Paper Distributors, Inc. Has Acquired High Country Paper Distributors, Inc. The undersigned served as exclusive advisor to Western Paper Distributors, Inc. SDR Ventures</p>
<p>August 2012 Capital Formation Principal</p> <p>Debt Financing Provided to JOYCE HOMES, INC. JOYCE HOMES, INC. Financing Provided by SDR Ventures</p>	<p>June 2012 Transaction Advisory Sell Side</p> <p>All used Fulfillment Has been acquired by new@ISTICS new@ISTICS, LLC The undersigned served as exclusive advisor to All used Fulfillment SDR Ventures</p>	<p>May 2012 Transaction Advisory Buy Side</p> <p>Mountain Tech Has been acquired by Cohio Ventures LLC The undersigned served as exclusive advisor to Cohio Ventures LLC SDR Ventures</p>	<p>February 2012 Sticky Ground Sticky Ground, Inc. d/b/a Sticky Press Has been acquired in a stock sale by Pioneer Pet Pioneer Pet Products, LLC The undersigned served as exclusive advisor to Sticky Ground, Inc. SDR Ventures</p>	<p>December 2011 Sticky Ground Sticky Ground, Inc. d/b/a Sticky Press Has been acquired in a stock sale by Sticky Ground The undersigned served as exclusive advisor to Sticky Ground, Inc. SDR Ventures</p>