

LBO Focus

Pet Product Deals Are Private Equity's Best Friend

By LILLIAN RIZZO

When Cloud Star Corp. hit the sale

block this year, private equity firms hungry for pet consumer product deals quickly circled the maker of all-natural dog treats and shampoos.

Five of the six initial indications of interest in the company came from private equity firms, said Carol Frank, a pet industry specialist and a managing director with investment bank SDR Ventures who worked on the deal.

"I was amazed at the interest from private equity and the premium multiples," said Ms. Frank. Ultimately, Chicago buyout shop **Frontenac Co.** bought the company for an undisclosed amount in July. Frontenac plans to expand Cloud Star through new-product innovation and select acquisitions, said Walter Florence, a managing partner at Frontenac.

Private equity firms can't seem to get enough of pet product companies, making them some of the darlings of an already popular segment, thanks to steady, stable consumer demand for their products, even during challenging economic times, said consumer-focused general partners, investment bankers and analysts. Expenditures in the pet sector are expected to reach a record high of about \$58.5 billion in 2014, according to the American Pet Products Association.

Demand for such companies and a limited supply of targets have pushed up purchase-price multiples and forced some private equity firms to get more creative in their quest for deals.

Purchase-price multiples for consumable pet products businesses average in the double-digit range of earnings before interest, taxes, depreciation and amortization, while companies that produce hardline items, such as pet toys, tend to command multiples of seven to eight times, said Ms. Frank and other investment bankers.

"Consumable products are where the frothiest multiples are and command a 20% to 30% higher multiple than hardline products such as toys and bedding," said Ms. Frank.

Some of the same trends driving deal flow in other parts of consumer products industry, such as increasing demand for higher quality food, have manifested themselves in the pet sector, said Laird Koldyke, managing director at **Winona Capital Management**, owner of specialty pet retailer **Petsense LLC**.

"The consumer is changing how it buys pet food and the other pet items as well," said Christopher Sciortino, managing director at advisory firm Baird Global Investment Banking. "It's become both an appealing and emotional purchase. The consumer is also now seeing the appeal of local concepts and small box or regional retailers."

There were 23 pet-related transactions involving U.S. targets reported through the end of June 2014, putting the industry on pace to outdistance 2013, which saw 43 pet deals, according to investment bank Capstone Partners' quarterly analysis of the industry.

"I take no less than one call per week from a private equity firm that wants help with how to get a pet deal done," said Ms. Frank. "It's a very competitive market for companies of any scale – small, medium and large."

The industry remains highly fragmented and a number of companies have yet to reach a scale that makes them viable as platforms for private equity firms.

Ms. Frank and Daniel Schultz, director of business development at Capstone Partners, both said that one route firms are using to enter the industry is through add-on acquisitions. Firms are looking to bolt on to their portfolio companies, even if they aren't in the exact same industry but still are related to consumer products, Mr. Schultz added.

Select Pet Industry Deals Made by Private Equity Firms

Mid-October 2013 to Mid-October 2014

Date	Target	Acquirer	Description
11/13	InterHealth Nutraceuticals Inc.	Kainos Capital	Produces dietary ingredients for human and animal supplements
1/14	Phillips Pet Food & Supplies	Thomas H. Lee Partners	Distributor of pet foods & products to U.S. stores
5/14	C.J. Foods Inc.	J.H. Whitney Capital Partners	Manufacturer of dry pet food
5/14	SmartPak Equine LLC	Oak Hill Capital; Henry Schein Animal Health	Online retailer of horse supplies and pet food supplements
7/14	Cloud Star Corp.*	Frontenac Co.	Maker of all-natural pet treats and products

Sources: Capstone Partners Pet & Animal Q3 2014 report, Dealogic*



Wind Point Partners-backed Petmate, a manufacturer and seller of pet crates and products also known as **Doskocil Manufacturing Co.**, has made four add-on acquisitions since being acquired by the sponsor in 2011.

"In general, the industry has a lot of attention on it, so it's hard to find a hidden gem," said Paul Peterson, a managing director at Wind Point.

Other firms have found opportunities overseas. "We're seeing the pet trend emerge from places outside of the U.S., like in Brazil, where pet ownership is on the rise," said Mr. Koldyke.

Last year, **Warburg Pincus** acquired **Pet Center Comércio e Participações SA**, a Brazilian specialty pet retailer of food, accessories and services. Brazilian firm **DXA Investments** also recently purchased a minority stake in **Zee.Dog**, a maker of leashes, toys, bedding and other hardline items that serves the Brazilian and American markets. Its founders remain as majority owners.

Many firms are looking for smaller growth companies that will prove attractive to strategic acquirers, much like **Zuke's LLC**, which proved to be a hidden gem **Encore Consumer Capital** discovered, said two general partners. Encore acquired the maker of all-natural pet treats in 2010. The firm typically invests in early-stage companies with less than \$10 million in Ebitda.

In January, Encore sold Zuke's to Nestlé Purina Petcare Co., a division of Swiss food company Nestlé SA. Although the transaction sum was undisclosed, industry bankers, analysts and general partners said they believed it was "for a premium multiple," setting the bar for future deals.

Following the Zuke's acquisition, however, Nestlé has remained quiet, with the exception of litigation between

Nestlé Purina and premium pet food maker Blue Buffalo Co. In May, Nestlé Purina filed a lawsuit against the company, alleging Blue Buffalo falsely advertised certain all-natural ingredients in its products. Although this may have slowed Blue Buffalo's process of going public, it likely won't halt it for too long, said two bankers and a general partner. Blue Buffalo also filed a lawsuit in response, alleging Nestlé is falsely attacking the company, according to court documents.

The litigation could be distracting the two strategic buyers, giving sponsors a leg up on more deals, said another investment banker. A Nestlé spokeswoman said the company doesn't expect the Blue Buffalo litigation to have an impact on future acquisitions. Blue Buffalo didn't respond to inquiries for comment.

Encore owns another pet product, **Thundershirt**, which is a shirt that swaddles a dog or cat when it's anxious, such as during a thunderstorm or fireworks.

"There's a lot of new companies being founded, and there's new ones every year that enter right into our target strike zone," said Scott Sellers, managing director and co-founder of Encore.

Still, not many firms dive so far down into the lower midmarket, and many independent companies have sub-\$3 million in Ebitda, said two of the bankers.

"For private equity to get really comfortable, they need to at least see Ebitda in the \$3 million to \$5 million range, and there has to be high growth. When you think about the fees that go into making an investment, it's just too risky to go below that mark," said Capstone Partners' Mr. Schultz. ■