THE DEAL HOUND
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QUARTERLY PET INDUSTRY REPORT
Volume 2, Issue 1, Q1 2011

## Pet Industry Deal Activity – Q1 2011

The Pet Industry finished out the First Quarter of 2011 with a sizeable amount of M&A activity. Strategic acquisitions continue to dominate deal activity within the industry, with a particular focus on unique product and service offerings. Several of the deals in Q1 leveraged the core competencies of the purchasing companies, allowing for increased synergies and expanded product lines. First Quarter 2011 has followed the trends of Q4 2010, with numerous mergers and acquisitions involving financial and strategic industry insiders looking to grow through acquisition.

### *Pet Deal Activity Highlights*

| | |
|---|---|
| Strategic Acquisitions | **The Hillman Group** of **Oak Hill Capital Partners** acquired **TagWorks** for $40 million and may later pay two additional earn-out payments. TagWorks manufactures metal identification tags for pets and machines for marking pet identification tags (including pet ID tag program at PetSmart), while Hillman distributes fasteners, key duplication systems, engraved tags, and other related items.<br>**Excel Pac,** provider of flexible packing solutions (including pet food), was acquired by **Packaging Solutions Holdings** for an undisclosed amount.<br>**Quaker Pet Group** acquired **Sherpa Pet Group,** a manufacturer of pet accessories and toys for an undisclosed amount. Through this acquisition, the Quaker Pet Group establishes one-stop-shop resources in the specialty pet marketplace.<br>**Petmate** acquired pet product brand, **Bamboo,** the pet products division of Munchkin Inc., for an undisclosed amount.<br>**Hi Standard Pet Foods** has acquired **Joy Pet Foods** and **Best Feeds**, adding 22 new products to the portfolio of the Ogden, Illinois, USA, American Nutrition plant where its products are produced. |

| | |
|---|---|
| Financial Deals | **MidOcean Partners** acquired a significant equity position in **Freshpet,** manufacturer of refrigerated dog food. One of the firm's management affiliates, Richard Thompson co-invested alongside Mid Ocean Partners and will serve as the company's CEO.<br>**The Promivi Group's** pet food division was sold to **Advent International** for approximately $266 million. The deal will allow Promivi to focus on its farm animal feed and nutrition business.<br>**Del Monte Foods,** was acquired by an investor group led by **Kohlberg Kravis Roberts, Vestar Capital Partners and Centerview Partners** for $19 per share in cash; equating to approximately $5.3 billion. Del Monte produces, distributes and markets pet and food products.<br>**Petmate,** manufacturer of non-food pet products, was acquired by **Wind Point Partners** for an undisclosed amount. Prior to the acquisition by Wind Point Partners, Petmate was backed by Westar Capital (since a 1997 LBO).<br>**Animal Health International** has entered into a definitive merger agreement with **Lextron** under which Lextron will acquire all of Animal Health International's outstanding common shares for $4.25 per share, plus the repayment of the company's outstanding indebtedness, for a total of approximately $251 million. The newly combined company will operate under the Animal Health International name. |

| Seller | Buyer | Description | Deal Date | Deal Type |
|---|---|---|---|---|
| Flamingo N.V | Perusa | Belgian Pet Accessories company | 1-Apr-11 | Acquisition |
| The Promivi Group | Advent International | Animal nutrition company | 23-Mar-11 | Add-on |
| TagWorks | The Hillman Group | Manufacturer of metal ID tags for pets and machines for marking pet ID tags | 16-Mar-11 | Add-on |
| Animal Health International | Lextron, Leonard Green & Partners | Distributor of pharmaceutical products to the livestock market | 14-Mar-11 | Leveraged Buyout |
| Sundag | Hazorea Aquatics | Tropical fish exporter | 8-Mar-11 | Acquisition |
| Del Monte Foods | KK&R, Vestar Capital Partners, Centerview Partners | Producer, distributor and marketer of private label food and pet products | 8-Mar-11 | Leveraged Buyout |
| Excel Pac | Packaging Solutions | Pet food packing, among other packaging products | 1-Mar-11 | Add-on |
| Jolly Pets | Dig Pets | Manufacturer of toys for dogs and zoo animals | 25-Feb-11 | Acquisition |
| Joy Pet Foods | Hi-Standard Pet Food | Dog Food Manufacturer | 25-Feb-11 | Acquisition |
| Best Feeds | Hi-Standard Pet Food | Dog Food Manufacturer | 25-Feb-11 | Acquisition |
| Sherpa Pet Group | Quaker/New York Dog | Manufacturer of pet accessories and toys | 14-Feb-11 | Acquisition |
| Petmate | Wind Point Partners | Manufacturer of Non-Food Pet products | 24-Jan-11 | Leveraged Buyout |
| Bamboo Products | Petmate | Fat Cat brand dog and cat toys | 24-Jan-11 | Add-on |
| Freshpet | MidOcean Partners | Manufacturer of frozen pet food | 6-Jan-11 | Leveraged Buyout |

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## Spotlight

### *Pet Executive of the Quarter: David Blatte, CEO Quaker Pet Group*

**An Interview with SDR's Carol Frank**

***David Blatte** has had a successful track record of building businesses from start-up to IPO and has 25 years of experience investing in the consumer space. During his 25 year career David has invested in and helped formulate and implement successful strategies for numerous companies including: Healthy Pet; Starbucks Coffee; Build-a-Bear Workshops; and Dicks Sporting Goods. David has also served as a Board Member for many companies including serving as the Chairman of Audit Committee at a NASDAQ traded $1 billion toy/pet Company.*

***CAROL:** Why did you decide to start purchasing companies in the pet sector?*

**DAVID:** In the consumer category, the pet sector is one of the most exciting categories to be in. The dynamics and metrics are growing. The passion that people have for their pets make it a fun, exciting industry to be in. It's also a very fragmented market, which allows for opportunities to create synergies by combining operations, sales, back office, etc. No one or two players (i.e. Coke/Pepsi or McDonalds/Burger King) dominate the market; yet it is a multi-billion dollar market.

There is a lot of room for innovation in the pet sector. The wants and needs of pet owners are not being thoroughly serviced.

***CAROL:** Where will the pet sector be in 5 years/10 years?*

**DAVID:** The pet sector will continue to grow. A lot of newer, more specialized categories servicing the needs of dogs and dog owners will be introduced. We observed this over the last 10 years in food and supplements. We look at the unmet needs of the pet owner and how to fulfill them. For example, once upon a time, there was a one-size fits all golf club. Now clubs are highly specialized to fit a person's exact needs. Same thing will happen with pets. Biggest growing demographics for pet ownership are female baby boomers. 70 is the new 40.

***CAROL:** What is the largest change the industry has undergone since you began?*

**DAVID:** Back when I was with Donaldson, Lufkin, and Jenrette, one of the first deals I financed was PetSmart. Once-upon-a-time, there were no superstores. Now between PetSmart and Petco there are over 2000 super stores that didn't exist 25 years ago.

***CAROL:** What advice would you give to the small or mid-sized pet company owner in terms of maximizing the value of their business?*

**DAVID:** Look to join forces with other pet companies that will bring synergistic values and have different channels of distribution, product categories, sales people and offer more products to more customers. This will create an economies-of-scale that goes straight to the bottom line. It's great to be able to work in an industry that you can't wait to come to work and satisfying the needs of the animals that you love.

***CAROL:** What are some of the biggest lessons you have learned since starting your business?*

**DAVID:** Don't bite off too much in the beginning – slow and steady growth is better than a hockey stick. I have seen so many entrepreneurs do that! Instead, look for long term profitability and equity growth. Look to build a foundation.

Hire people that are smarter then you. Pay attention to the customer - listen to their suggestions, etc.

I've seen companies fail to diversify, be too reliant on one customer, and then that customer has you over barrel. That is not a place you want to be.

***CAROL:** What steps can a company take to make themselves most attractive to a buyer?*

**DAVID:** Don't produce "Me Too" products. Differentiate through products, superior customer service, your management team, and distribution. That sets you apart from everyone else. That way, it will be easier to buy you then replicate you. We look at acquisitions as a partnership versus a buyout. I want to partner with the people who have helped build the company.

"Look for long term profitability and equity growth. Look to build a foundation. "

### *Sniffing Out a Deal – Quaker Pet Group Acquires Sherpa Pet Group*

February 14, 2011

Quaker Pet Group

QPG

Acquires

Sherpa Pet Group™

**Acquisition Type:**
*Strategic*

**Top 6 Value Drivers:**
*Diverse product lines*
*Distributor relationships*
*Strong retail positioning*
*Quality Management Team*
*Vendor sourcing*
*Production Capabilities*

Quaker Pet Group, the parent company of New York Dog, acquired Sherpa Pet Group, a Rockaway, N.J.-based manufacturer of pet accessories and toys on February 14, 2011.

Sherpa Pet Group manufactures collars, harnesses, carriers and toys under the brands Sherpa's Pet Trading, Fox & Hounds, Cloak & Dawggie, GoDog, Luna Brite, Dog Mountain, Pez for Pets and Woof Wear Organics.

Quaker Pet Group was formed by industry veterans David Blatte and Neil Werde. "Quaker Pet Group's goal is to build a world-class pet accessories business across a broad spectrum of product categories and distribution channels," according to David Blatte.

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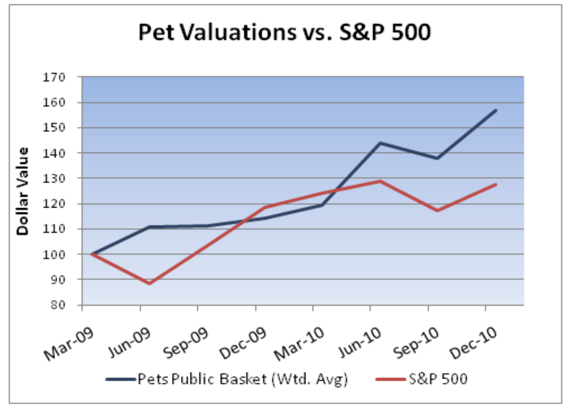
# M&A Market Overview

## *Valuation Trend*

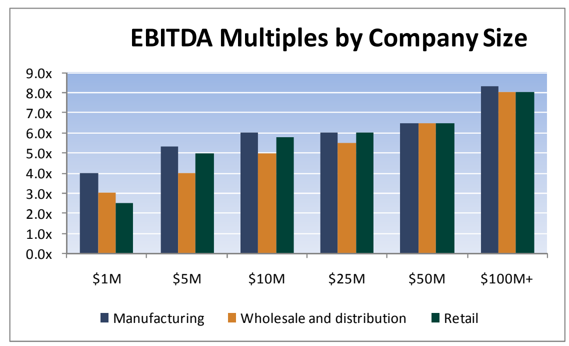
The pet industry proved resilient in the latest economic downturn. All but two of SDR's Pet Industry Public Basket companies outperformed the S&P 500 over the past 5 years. As of December 31, 2010, the average P/E for the Pet Industry Public Basket is 17.56x, meaning for every dollar of earnings, investors would pay $17.56. Compare this to the average P/E of the S&P 500 which is 14.00x and one can see that investors over the past 5 years have found pet companies to be more valuable than the large cap stocks of the S&P 500.




## *2010 Deal Multiples*

1Recent activity suggest that buyers are willing to pay approximately 4.0x – 8.0x EBITDA in the majority of transactions across all industries. The Winter 2011 Pepperdine Capital Markets Study interviewed 245 investment banks, who indicated that bigger companies receive higher valuations. Additionally, manufacturing and retail business models typically receive larger EBITDA multiples than wholesale and distributions business models.

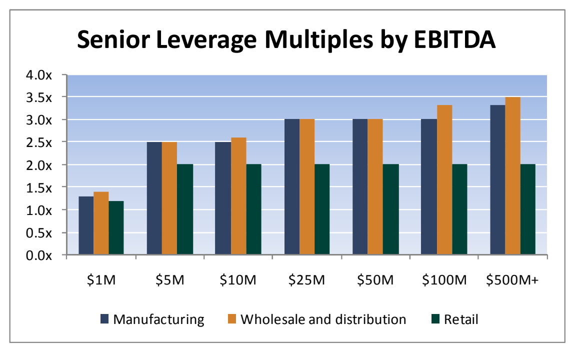
Valuations for the manufacturing model in the pet industry are predicated completely on niche and intellectual property. Wholesale and distribution is driven on customer base, fixed assets and gross margin more than cash flow, which is why EBITDA multiples are somewhat lower. Retail valuations are driven by sales per square foot and sales per employee. Good numbers in these two metrics in comparison to peers drive high valuations in the retail space.




## *2010 Senior Debt Leverage Multiples*

In the Winter 2011 Pepperdine Capital Markets Study, 68 institutional lenders and banks were surveyed to determine senior debt leverage multiples across manufacturing, distribution, and retail verticles and all sizes of companies. The study found that Senior leverage multiples of EBITDA range from 1.25x to 4.0x depending upon industry and size of company (EBITDA).

The single most important factor in approving loans identified by banks was cash flow available to service debt. The median debt service coverage ratio for approved loans (EBITDA/Total debt payments) was 1.3 in 2011.

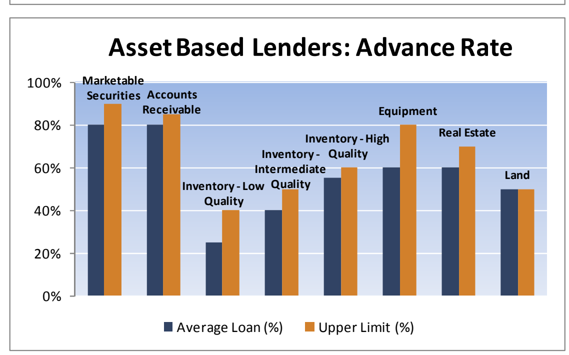



## *2010 Asset Based Lending*

Asset-based debt is any type of debt secured by a specific asset. Asset-based lenders (ABL's) generally lend toward assets like accounts receivable, inventory, or equipment. The highest advance rates (75% - 90%) are typically to marketable securities, accounts receivable, and equipment depending upon quality.

The Pepperdine Capital Markets Study surveyed 74 asset based lenders to determine the average and upper limit advance rates (loan to asset value). Marketable securities, accounts receivable, and equipment typically yield the average advance rate.

For loan amounts of $1 to $5 million, the cost of capital including fees was on average between 10% and 18%. For loan amounts greater than $5 million, the average cost of capital was between 3% and 9%.




*Sources:*
*Capital IQ*
*Pepperdine Capital Markets Survey*
*SDR Ventures*

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## Quarterly Pet Industry Report

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

***Carol Frank (cfrank@sdrventures.com), 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.

### *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.

*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 Business Development team."

**Capital Formation**

*Principal*

In 2008 we established a dedicated fund, committed to providing liquidity to privately held companies. To-date we have funded 26 subordinated debt deals and invested a total of over $32.5 million.

*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.

**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

### *Recent Transactions*