

VALUE FOCUS

Animal Health Industry



SEGMENT FOCUS
Retail & Pet Services

2015

Retail & Pet Services

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Animal Health Industry

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SEGMENT FOCUS

Retail and Pet Services

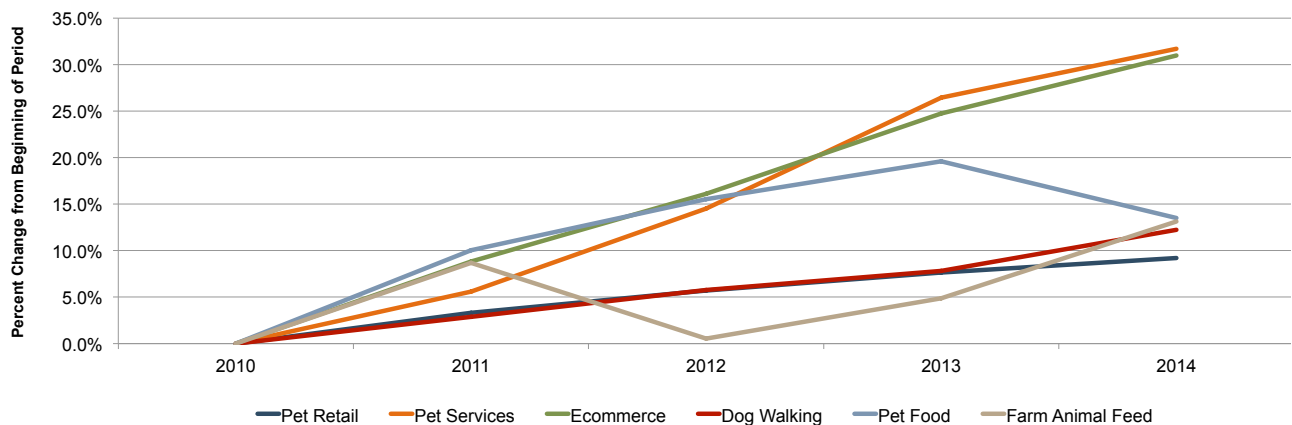
2015 Second Quarter

General Overview

The pet retail and services industry includes grooming services, pet training, boarding facilities, and specialty stores that provide pet products and food. During 2014, the pet retail store segment generated \$15.7 billion in revenue, a 1.4% increase over the prior year. Boarding

and grooming services generating \$6.0 billion, a 4.1% increase over 2013. The Animal Pet Products Association (APPA) estimates that \$58.0 billion was spent in the United States in 2014 in the pet industry, representing an annualized increase of 3.7% relative to 2010.

Pet Retail and Services Revenue



Source: IBIS World

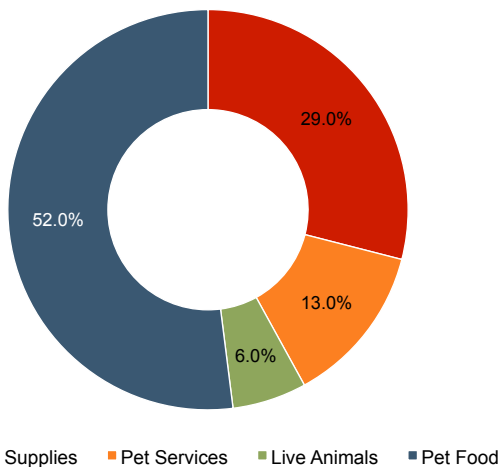
Brick and Mortar Retail Stores

Pet food is the largest segment of the pet retail industry. Animal food production generated \$61.7 billion in 2014, declining 5.1% from 2013. Increasing pet food sales offset a decline in livestock feed sales. High profit margin items, such as natural and organic pet food, are expected to continue gaining popularity. Animal feed revenue is expected to remain stable during the five year period ending 2015, although profit margins are generally expected to increase.

Many retail stores have also started offering veterinary services and pet services in-store. PetSmart Inc., the largest company in the industry, had 861 in-store, full service veterinary clinics as of November 2014. Retail stores have also been expanding their offerings of grooming, boarding, and training services.

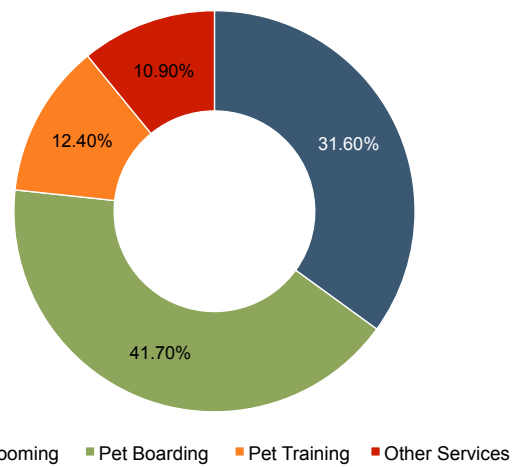
Large chain store retailers have been crowding out smaller, closely held pet stores during the past decade. PetSmart and Petco Animal Supplies, Inc. control 41.9% and 20.6% of the retail pet industry, respectively. While large box stores continue to dominate the retail market, mid-size specialty stores have experienced increased growth in the past two years and over 80% of pet supply companies employ fewer than five employees. Specialty stores, which often focus on natural, locally sourced, or organically made products, seek to differentiate themselves from established chains through the quality of their offerings, while still leveraging economies of scale found in larger operations.

Products and Services Offered by Pet Stores



Source: IBIS World

Pet Services Revenue



Source: IBIS World

Average Annual Expense in Dollars per Owner

	Dog Owners	Cat Owners
Food	\$269	\$246
Treats	61	51
Toys	47	28
Grooming	83	43
Kennel Boarding	333	130
Vitamins	62	33
Total Non Veterinary Expenses	\$855	\$531

Source: APPA

Ecommerce

Eighty percent of pet retail stores have websites and 30% have online sales. The online pet food and pet supply industry generated approximately \$3.3 billion in 2014, an increase of 5.0% from the previous year and an annualized increase of 7.0% since 2009. The recent recession had fewer repercussions for online retailers than for traditional brick and mortar stores. In general, online shoppers are more price-sensitive due to the ease of comparing prices across on-line retailers. This, in turn, causes online retailers to be more price conscious than their brick and mortar counterparts.

States are increasingly requiring online retailers to collect sales tax, dampening profits. As of the first quarter of 2015, 24 states were participating in the Sales Use and Tax Agreement by the Streamlined Sales Tax Governing Board, which charges sales tax based on the delivery address. Changes in tax law could diminish online retailer's competitive price advantage over brick and mortar stores.

Pet Services

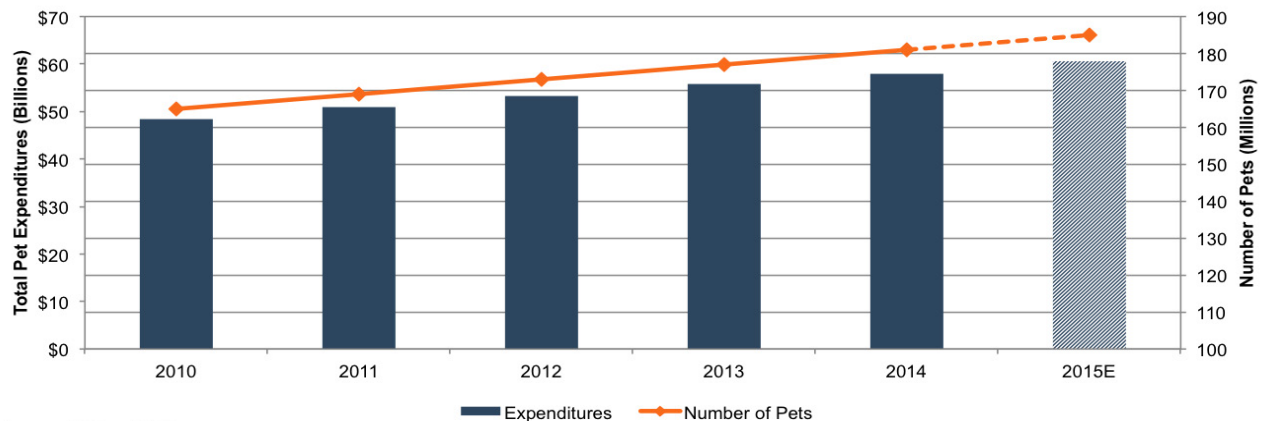
Pet grooming and boarding revenues increased 7.1% on an annualized basis over the past 5 years and generated over \$6.0 billion in revenue in 2014. The pet services industry has more than doubled during the past ten years, and revenue is expected to continue to grow at an annual rate of 5.0% through 2019. Rising pet ownership, declining unemployment, and increasing disposable income are expected to contribute to the anticipated growth of the pet services industry.

Industry competition is expected to intensify further due to new pet services providers entering the market. Large stores, as well as niche and luxury providers, are increasingly offering services.

Traditional brick and mortar retailers are moving to take advantage of the rapid growth afforded by this sector of the industry. PetSmart reported that 12.0% of revenue for the 39 weeks that ended November 2014 was generated by pet services, including grooming, training, daycare, and boarding. Revenue growth in the pet services segment continues to outstrip revenue growth from other sources. Petco and PetSmart both offer grooming in many of their locations.

In order to distinguish themselves from low-cost services in private residences, formal boarding and grooming facilities are expanding luxury services, including undercoat removal and pet massage. Increasing numbers of pets are expected to provide new opportunities for pet training, which generates 12.4% of the pet services segment revenue. Dog walking franchises started emerging in the past decade and are expected to expand in the future. Revenue generated from the dog walking market has grown at an annualized rate of 2.9% over the five year period prior to 2014. Dog walking services generated \$907.3 million in revenue during 2014, an increase of 2.8% from 2013.

Number of Pets and Pet Expenditures



Source: APPA and IBIS

M&A Activity

In December 2014, PetSmart announced its pending acquisition by a group of private equity firms led by BC Partners. PetSmart stock slid over 18% in the first half of 2014. On July 3, 2014, activist investor Jana Partners' (which owned approximately 9.9% of PetSmart prior to the transaction) began calling for PetSmart to sell itself. The action of Jana Partners led to a slight recovery in the share price. The acquisition was completed in March 2015, following approval by PetSmart stockholders. Shareholders received a cash payout of \$83.00 per share, which represents a 39% premium over the July 2,

2014 price (the day before Jana Partners became an active investor) and a 6.9% over the prior day's price. The purchase price resulted in a total enterprise value of \$8.8 billion and implied an EV/Revenue multiple of 1.3x and an EV/EBITDA multiple of 9.0x.

In the chart below, the first vertical line marks July 2, 2014, one day prior to the Jana Partners call for a sale of the company. The second vertical line marks the announcement of the transaction.

PETM % Change from January 2014



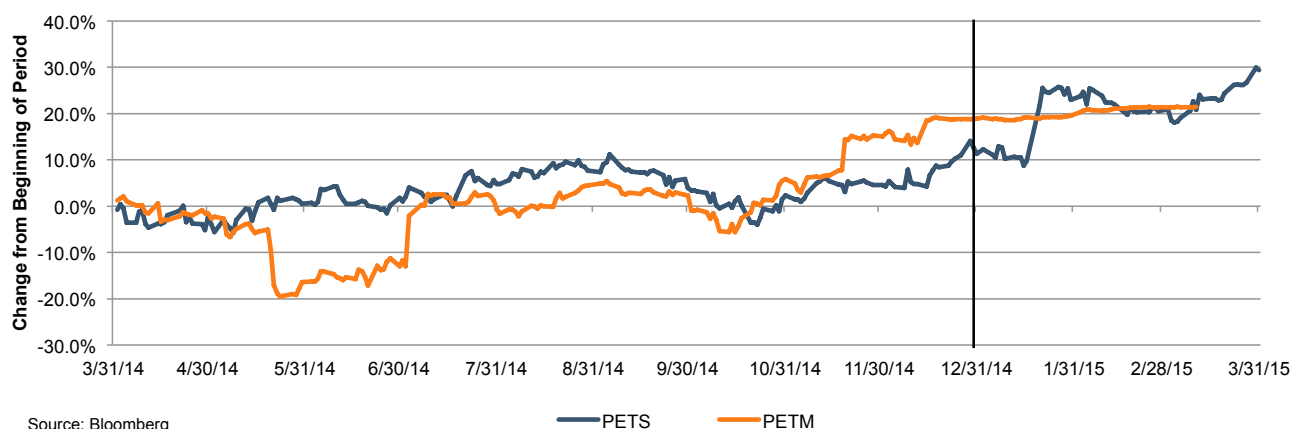
Source: Capital IQ

Equity Market Overview

Following the acquisition of PetSmart, PetMed Express (PETS) is the only major publicly traded player in the pet retail industry. PetMed Express sells companion animal pharmaceuticals directly to consumers using an online market place. PetMed share prices rose nearly 30% during the past twelve months relative to March 31, 2014. Cooler-than-typical summer weather in many parts of the

country impacted the company's revenue and profit earlier in the year. However, the announcement of PetMed's quarterly financial results in late January prompted a significant jump in share price based on improving gross profit margin. PetMed's EBITDA margin generally kept track with its improving financial performance.

Veterinary LTM Stock Performance



Trends in EBITDA Pricing Multiples

	Q2 2014	Q3 2014	Q4 2014	Q1 2015
VCA, Inc. (WOOF)	10.49	11.19	13.24	14.61
MWI Vet Supply (MWIV)	11.19	13.24	14.61	17.03
Pet Smart (PETM)	7.42	6.55	7.53	9.00
PetMed Express (PETS)	8.11	8.00	8.21	9.39
Heska, Inc. (HSKA)	nm	12.97	19.22	22.14
Zoetis, Inc. (ZTS)	14.81	15.92	18.37	19.27
IDEXX Laboratories (IDXX)	20.97	17.89	23.51	24.06
Phibro Animal Health (PAHC)	13.82	11.89	15.05	15.76
Abaxis, Inc. (ABAX)	28.49	29.72	29.63	31.21
Aratana Therapeutics (PETX)	nm	nm	nm	nm
Parnell Pharmaceuticals (PARN)	nm	nm	nm	nm

Source: Capital IQ

Note: PETM and MWIV Q1 2015 multiples reflect the multiples implied from the sale of the companies (MWIV was sold in February 2015 and PETM was sold in March 2015)

Note: Multiples may not tie to Bloomberg information due to differences in adjustments

Sector Outlook

During the recession, supermarkets and online retailers lured customers away from specialty pet stores with low prices and convenient shopping. Pet retail stores are expected to continue consolidating due to this increased competition, but they can find a competitive edge with specialty products that cannot be sold at

supermarkets. Niche pet food and treat producers selling homemade, organic, or other specialty items have grown in popularity, typically selling higher margin products. Pet-related services are expected to continue their recent rapid growth.

Publicly Traded Animal Health Companies

Company Name	Ticker	Mar-15 Price (\$)	52 Wk Perform (%)	Sales (\$)	Enterprise Value (\$M)	Debt/ Mart. Cap	EBITDA Margin	EV/ EBITDA (x)	EV / Next Yr EBITDA (x)	P/E (x)
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Veterinary Services

VCA Inc.	WOOF	54.82	70.1%	82.94	8,763.64	14.9%	17.0%	16.35	12.42	35.83
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Pet Retail

PetSmart Inc	PETM	82.98	21.4%	7,111.97	8,763.64	5.8%	nm	nm	8.47	19.48
PetMed Express Inc	PETS	16.52	29.4%	228.03	334.75	0.0%	12.10%	12.13	11.02	19.21
Median-Pet Retail		49.75	25.4%	3,670.00	4,549.20	2.9%	12.1%	12.13	9.75	19.34

Animal Pharmaceuticals and Biotech

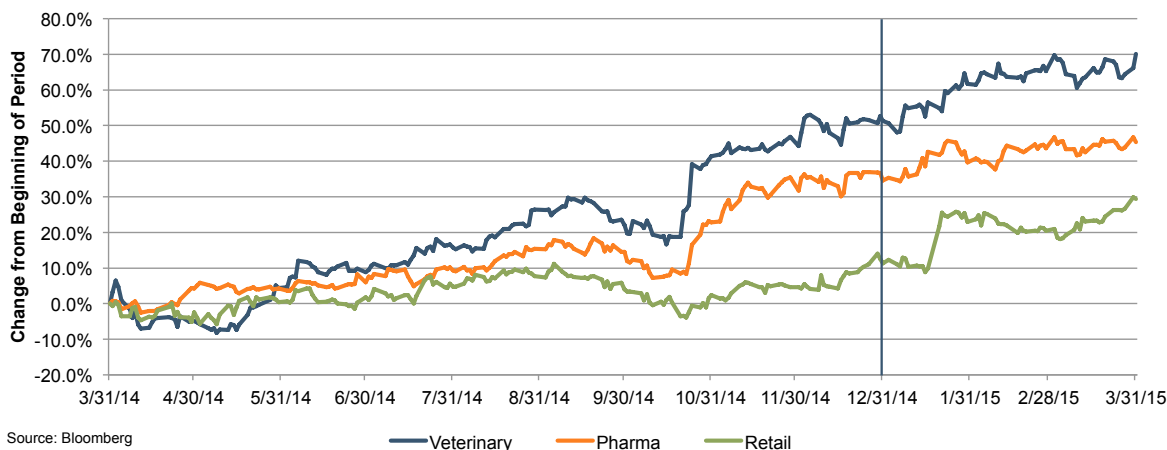
Heska Corp	HSKA	25.78	144.6%	89.02	151.77	1.5%	8.19%	20.82	13.08	64.45
Zoetis Inc	ZTS	46.29	nm	4,785.00	26,856.45	13.6%	23.99%	23.39	16.93	39.91
IDEXX Laboratories Inc	IDXX	154.48	27.2%	1,485.81	8,217.18	10.9%	21.48%	25.75	18.92	43.39
Abaxis Inc	ABAX	64.11	66.2%	202.96	1,445.29	0.0%	19.84%	35.89	27.76	72.85
Aratana Therapeutics Inc	PARN	4.91	nm	6.90	30.57	91.3%	nm	nm	nm	nm
PetMed Express Inc	PETS	16.52	29.4%	228.03	334.75	0.0%	12.10%	12.13	11.02	19.21
Parnell Pharmaceuticals Holdings Ltd	PARN	4.91	nm	6.90	30.57	91.3%	nm	nm	nm	nm
Median- Animal Pharm & Biotech		25.78	47.8%	202.96	334.75	10.9%	19.84%	23.39	16.93	43.39

Source: Bloomberg

Note: PetSmart was acquired on March 12, 2015. The values represented here are the most recently available.

Note: Aratana's and Parnell's recent IPOs have resulted in nonmeaningful multiples and ratios in the short term.

Median Percent Change in LTM Stock Prices by Industry Segment



Source: Bloomberg

Note: Due to the acquisition of MWIV, the Veterinary segment represents only the performance of WOOF. Due to the acquisition of PETM, the retail segment represents only the performance of PETS.

Mercer Capital

Animal Health Industry Services

Mercer Capital has expertise providing business valuation and financial advisory services to companies in the animal health industry.

Industry Segments

Mercer Capital serves the following industry segments:

- General, Specialty, and Emergency Care
- Pharmaceutical & Biotechnology
- Retail and Pet Services

Services Provided

- Valuation of animal health companies and veterinary practices
- Transaction advisory for mergers and acquisitions
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

Contact a Mercer Capital professional to discuss your needs in confidence.

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