

VALUE FOCUS

Animal Health Industry



SEGMENT FOCUS

Retail & Pet Services

2016

Retail & Pet Services

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Animal Health Industry

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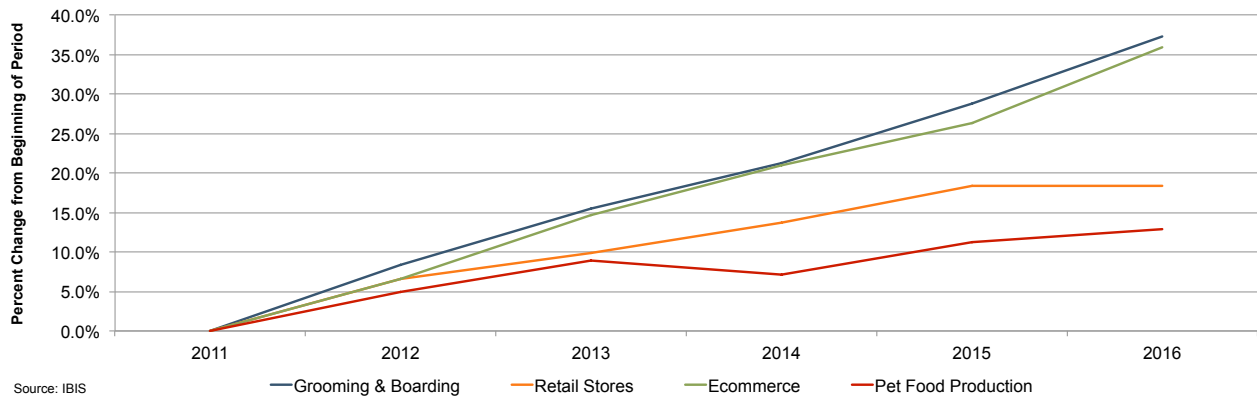
Q1: Veterinary Services
Q2: Retail & Pet Services
Q3: Veterinary Services
Q4: Pharmaceutical & Biotechnology

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 2015, the pet retail store segment generated \$17.7 billion in revenue, a 4.0% increase over the prior year. Boarding and grooming services generated

\$6.3 billion, a 6.2% increase over 2014. The Animal Pet Products Association (APPA) estimates that \$60.3 billion was spent in the United States in 2015 in the pet industry, representing an increase of 3.9% over 2014 and an annualized increase of 4.3% relative to 2011.

Pet Retail and Services Revenue

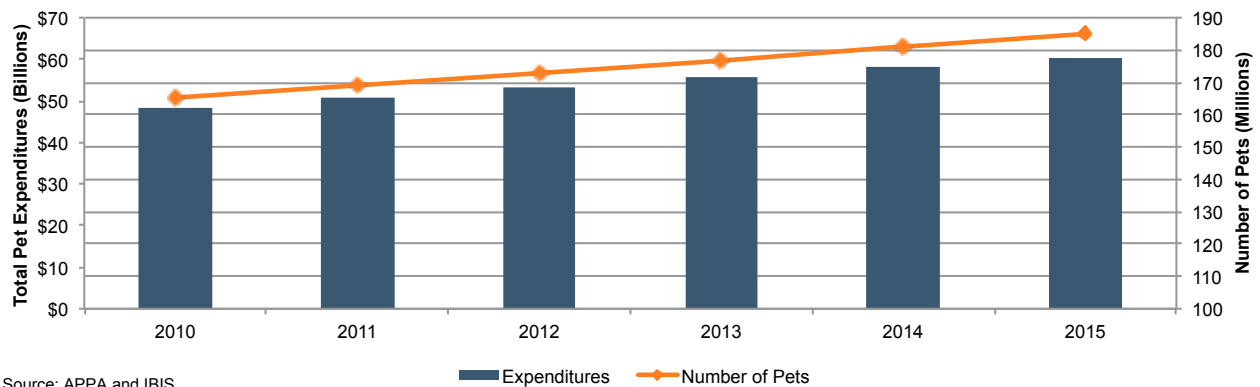


Pet Ownership

The number of pets and the prevalence of pet ownership in the U.S. have a strong impact on many facets of the retail and pet services segment of the animal health industry. The American Pet Products Association (APPA) reports that over 54.4 million

households own a dog and 42.9 million households own a cat. Over 65% of U.S. households own a pet. Rising disposable income is expected to increase pet ownership. The number of pets is expected to increase by 1.9% annually through 2020.

Number of Pets and Pet Expenditure



Brick and Mortar Retail Stores

Pet food remains the largest segment of the pet retail industry, although demand for other pet supplies has grown over the past year.

Pet food production is estimated to have generated \$24.9 billion in 2015, increasing 3.8% over 2014. The production of dry dog food accounted for 43% of total pet food revenue. The decline in grain prices has resulted in strong pet food margins over the last several years, allowing producers to hit margins of 5.3% in 2015. High profit margin items, such as natural and organic pet food, are expected to continue gaining popularity. As the number of pets continues to grow, pet food revenue is expected to increase modestly during the next five years and profit margins are expected to be stable.

Large chain store retailers have been crowding out smaller, closely held pet stores during the past decade. Many pet supply retail stores offer in-store veterinary and pet services, including grooming, boarding, and training. PetSmart and Petco Animal Supplies, Inc. control 37% and 23% 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 the majority of businesses have fewer than four 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. Many manufacturers will only sell high-end and premium pet products to specialty pet stores, aiding specialty retailers.

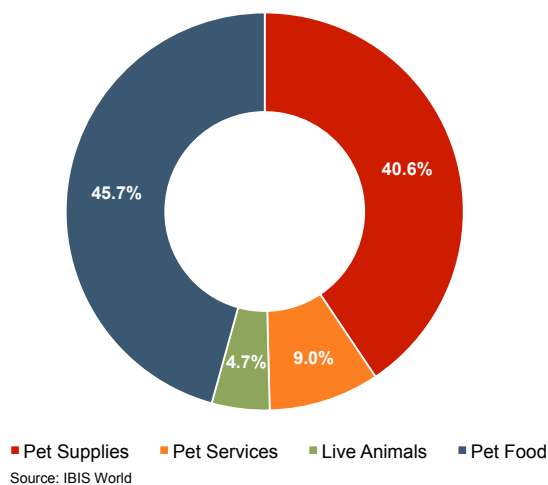
Average Annual Expense in Dollars per Owner

2015-2016 APPA National Pet Owners Survey

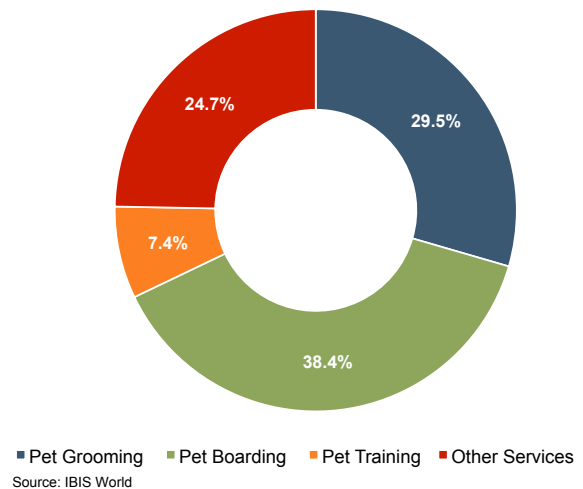
	Dog Owners	Cat Owners
Food	\$269	\$246
Treats	61	51
Toys	47	28
Grooming	83	43
Kennel Boarding	333	130
Vitamins	62	33
Total Non Veterinary Expenses	\$855	\$531

Source: APPA

Products and Services Offered by Retail Pet Stores



Grooming and Boarding Services



Ecommerce

A growing number of pet retail stores have an online presence. The online pet food and pet supply industry generated approximately \$3.6 billion in 2015, an increase of 4.4% from the previous year and an annualized increase of 6.6% since 2010. 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. The prevalence of websites, such as Etsy and eBay, and sales technology, such as Squarespace and Shopify, have enabled small-scale, specialty, and niche producers to more easily enter the world of online sales.

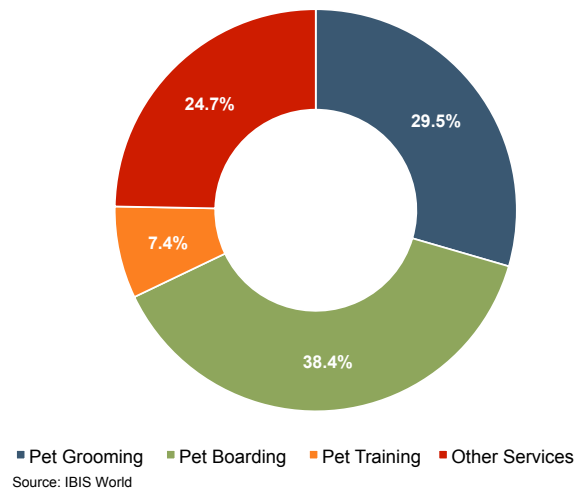
Pet Services

Pet grooming and boarding revenues increased 6.6% on an annualized basis over the past 5 years and generated over \$6.3 billion in revenue in 2015. 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 4.9% through 2020. Rising pet ownership, declining unemployment, and increasing disposable income are expected to contribute to the anticipated growth of the pet services industry.

Traditional brick and mortar retailers are moving to take advantage of the rapid growth afforded by this sector of the industry and are increasingly offering grooming, boarding, and training services in-store. Petco and PetSmart both offer grooming in many of their locations. 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. Revenue growth in the pet services segment continues to outstrip revenue growth from other sources.

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. Dog walking franchises started emerging in the past decade and are expected to expand in the future.

Grooming and Boarding Services

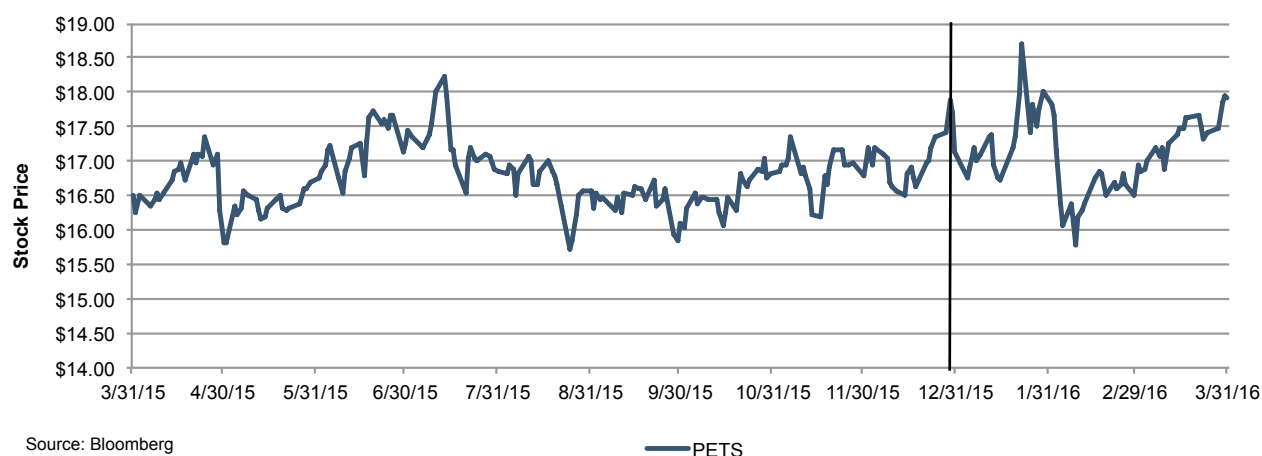


Equity Market Overview

Following the acquisition of PetSmart in 2014, 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 8.4% during

the past twelve months relative to March 31, 2015. PetMed's price peaked immediately prior to the release of its financial results for fiscal 2015 on January 25, 2016. Following the release, PetMed's stock price fell before recovering by the end of the quarter.

Animal Retail LTM Stock Performance



Trends in EBITDA Pricing Multiples

	2Q 2015	3Q 2015	4Q 2015	1Q 2016
VCA, Inc. (WOOF)	13.96	13.08	12.85	13.12
PetMed Express (PETS)	9.70	8.69	9.20	9.75
Heska, Inc. (HSKA)	22.43	17.58	19.45	13.63
Zoetis, Inc. (ZTS)	19.60	16.49	18.97	17.72
IDEXX Laboratories (IDXX)	20.91	23.19	20.35	21.31
Abaxis, Inc. (ABAX)	24.86	19.80	24.90	17.72
Phibro Animal Health (PAHC)	16.61	14.48	13.54	12.73

Source: Capital IQ

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 are not typically 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

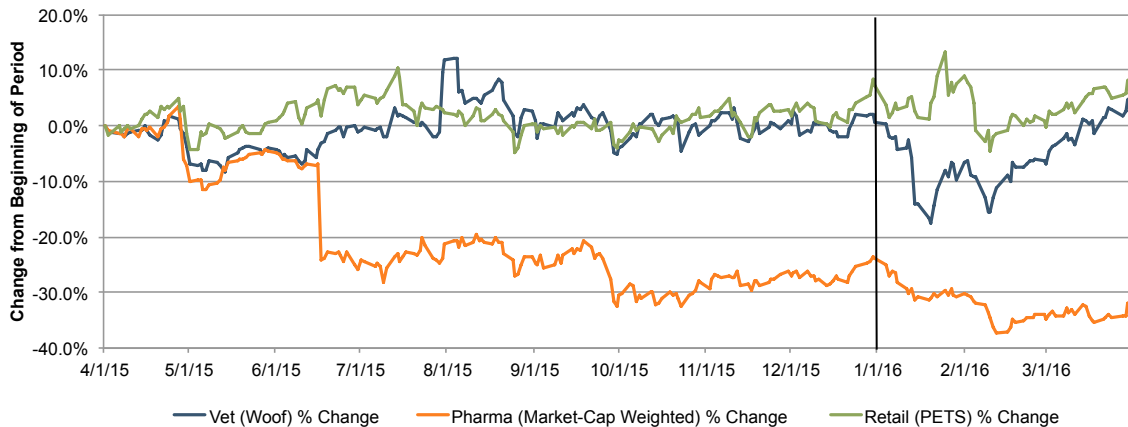
Company Name	Ticker	3/31/16 Price (\$)	52 Wk Perform (%)	Sales (\$)	Enterprise Value (\$M)	Debt/ Mart. Cap	EBITDA Margin	EV/ EBITDA (x)	EV / Next Yr EBITDA (x)	P/E (x)
Veterinary Services										
VCA Inc.	WOOF	57.69	6.4%	81.20	5,642.66	17.0%	19.6%	13.13	11.04	24.67
Pet Retail										
PetMed Express Inc	PETS	17.91	15.1%	229.29	364.07	0.0%	14.10%	11.26	11.92	17.91
Animal Pharmaceuticals and Biotech										
Heska Corp	HSKA	28.50	10.1%	104.60	189.19	0.2%	12.18%	14.85	9.23	38.51
Zoetis Inc	ZTS	44.24	-3.5%	4,765.00	26,871.99	18.1%	19.92%	28.32	14.09	65.06
IDEXX Laboratories Inc	IDXX	78.32	3.2%	1,601.89	8,218.49	14.2%	23.03%	22.28	18.82	38.20
Abaxis Inc	ABAX	45.39	-28.2%	213.96	1,032.16	0.0%	23.17%	20.82	19.79	38.77
Aratana Therapeutics Inc	PETX	\$5.52	-64.7%	0.68	230.50	17.2%	nm	nm	-6.15	nm
PetMed Express Inc	PETS	17.91	15.1%	229.29	364.07	0.0%	14.10%	11.26	11.92	17.91
Parnell Pharmaceuticals Holdings Ltd	PARN	2.13	-57.0%	15.50	18.14	96.5%	nm	nm	nm	nm
Phibro Animal Health Corp	PAHC	27.04	-23.3%	751.34	1,366.27	22.3%	14.52%	12.52	11.00	13.59
Jaguar Animal Health Inc	JAGX	1.58	nm	0.26	18.79	31.7%	nm	nm	nm	nm
Kindred Biosciences Inc	KIN	3.45	-49.9%	0.00	68.44	0.0%	nm	nm	-2.73	nm
Median- Animal Pharm & Biotech		22.48	-23.3%	159.28	297.29	15.7%	17.2%	17.83	11.46	38.36

Source: Bloomberg

Note: Aratana, Parnell, Jaguar, and Kindred current income results in nonmeaningful multiples

Note: PetSmart and MWI Veterinary no longer included due to acquisitions in the first quarter of 2015.

Median Percent Change in LTM Stock Prices by Industry Segment



Source: Bloomberg

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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