

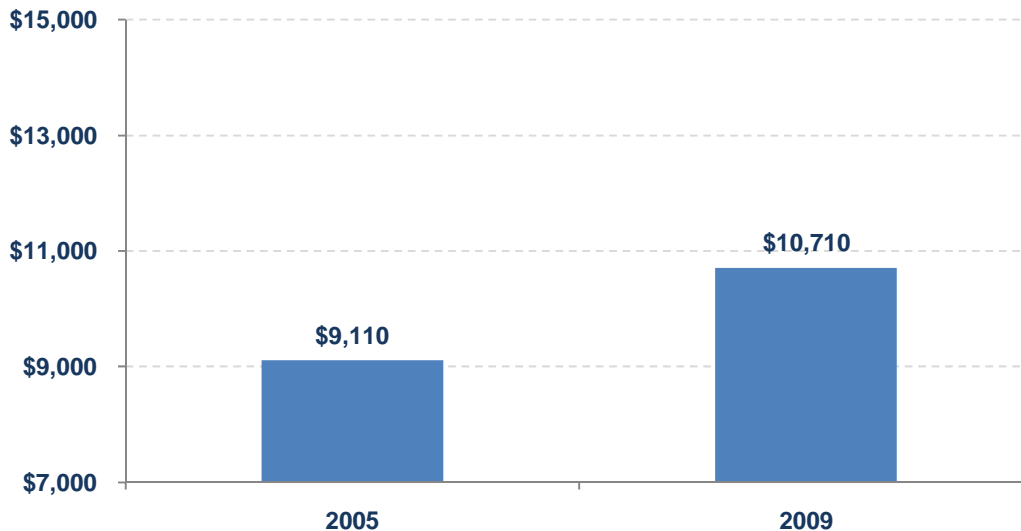
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U.S. Pet Supplies Market Expecting Pent-Up Demand

Retail Sales Near \$11 Billion in 2009

Packaged Facts estimates that U.S. retail sales of non-food pet supplies totaled approximately \$10.7 billion in 2009, up 2.5% over 2008. During the five-year 2005-2009 period, the market increased by a total of 17.6% and posted a compound annual growth rate (CAGR) of 4.1%. As a result of the economic recession, growth slowed in 2008 and 2009 as consumers reduced spending in non-essential categories and traded over to lower-priced products and value-oriented channels.

U.S. Retail Sales of Pet Supplies: 2005 vs. 2009 (in millions of dollars)



Source: Packaged Facts, *The U.S. Market for Pet Supplies and Pet Care Products, 7th Edition* report (January 2010)

Dogs account for the lion's share of sales of pet supplies, at 61% in 2009, followed by cats at 33%. The balance of sales goes to other animal types, with fish and reptiles slightly edging out birds and small animals, at 55% to 45%, respectively. Flea/tick products are the top-selling dog category by a significant margin, accounting for almost one-quarter (23%) of dog supply sales during 2009 (inclusive of products restricted to the veterinary channel). The cat side of the aisle is dominated by the staple litter, which accounted for 43% of cat supply sales during

2009.

PetSmart/Petco Duo the Leading Retail Force

In the U.S. market, pet stores are the top channel for non-food pet supplies by a considerable margin, representing nearly half (46%) of sales in 2009. Most of these pet specialty sales trace back to PetSmart and Petco, which together accounted for almost a third (31%) of the market in 2009, with independents pulling in less than half that amount (15%). Supermarkets continue to slide, to 10% in 2009, while mass merchandisers continue to rise. From 2005 to 2009, the mass sector's market share went from 22% to 23%, no doubt benefiting from the recession as consumers traded down across brands and consolidated shopping trips. Another retailing bright spot is online, and with pet products showing up in a wider-than-ever array of channels, "other" channels' collective share is also on the ups.

Mergers & Acquisitions Ongoing

Despite the global economic meltdown and uncertainties surrounding major financial and lending institutions, the pet market saw several mergers and acquisitions in 2008 and 2009. On the non-food side, these included Bramton's purchase of Veterinarian's Best, Radio Systems' purchase of MultiVet International, and Sergeant's purchase of Chomp and of Virbac's Consumer Brands division. Activity has been slower on the pet food side, with no major shifts occurring either year, although Old Mother Hubbard/Wellness (a top brand in the pet specialty channel) went from one venture capitalist to another. While still quite respectable, this level of activity pales in comparison to that seen earlier in the decade, with such dramatic shifts as Rayovac's 2005 market entry and subsequent creation of Spectrum Brands, and Hartz's summer 2004 acquisition by Japan's Sumitomo.

2009 a Record Year for New Product Entries

The U.S. pet supplies market relies on new products as a principal sales driver, with upgrades and innovations constantly appearing to pique consumer interest and open retail doors, and marketers were apparently relying on new products more than ever during the economic downturn. According to Product Launch Analytics, a Datamonitor service, the numbers of new product lines and stock-keeping units (SKUs) jumped sharply in 2009, with the number of

reports increasing 57% to 213, and the number of SKUs increasing 84% to 735. Considering the previous four-year period, this is the highest level of new product activity by far, with just 148 reports and 402 SKUs appearing in 2005. Despite the weak U.S. economy, the top package tags and marketing claims make it clear that the pet market continues to shift in premium directions. At the top of the list is natural, which appeared in 102 new product reports, up from 65 in 2008.

Economic Concerns Intensify Cross-Channel Competition

As of spring 2010, cross-channel competition is at an all-time high in the U.S. market as consumer trends adopted during the recession persist, from spending cutbacks to consolidated shopping trips. Signs of the challenges retailers face include fierce competition between big-box pet specialty and mass, private-label incursions into non-food pet products, declining sales among independent pet specialty retailers, and price promotions across all retail sectors. In such an environment, value-oriented retailers stand to cash in, as Walmart has been aggressively working to do. According to Packaged Facts' February 2010 pet owner poll, 52% of pet owners agree with the statement "I shop for pet products at a variety of stores to find the best prices, special offers, and sales," with 16% strongly agreeing and 34% somewhat agreeing. On the other hand, only 30% of survey respondents report that they do not engage in deal-seeking behavior of this sort.

Level of Pet Owner Agreement with Statement: "I Shop for Pet Products at a Variety of Stores to Find the Best Prices, Special Offers and Sales," February 2010 (number and percent of pet owners)

Agree*	50.5%
No Opinion/Not Applicable	19.8
Disagree*	29.7
Total	100.0%

* "Strongly" or "somewhat."

Source: Packaged Facts, *U.S. Pet Market Outlook 2010-2011* report (March 2010), based on Packaged Facts online poll (February 2010)

With these same trends continuing into 2010, retailers are employing a variety of strategies to draw shoppers into the store, and cooperative promotional programs with vendors are going strong. For retailers, one of the biggest advantages of co-op promotions is that the big

consumer packaged goods outfits typically foot much of the bill, allowing retailers to impact trip decisions without compromising their own margins too drastically. Coupon offers also can be highly effective in supporting store loyalty programs such as Petco's P.A.L.S. and PetSmart's PetPerks, while forming the core of collaborative special events programs between retailers and manufacturers, à la PetSmart's President's Day sale featuring Hill's Science Diet and its new lower pricing.

Looking Ahead

Despite the economic setbacks of the past couple years, numerous signs point to continued good growth in U.S. sales of pet supplies, including the industry's success in playing up the human-animal bond to drive higher-ticket sales; an ongoing surge of premium products responding to strong consumer demand and reminiscent of human fare; the growing role of premium demographics in the market; the growing population of pets with specialized health needs; and continued retail expansion in both traditional and non-traditional retail venues. As a result, with the economy on a slow but apparently steady recovery path, Packaged Facts is predicting a better showing for pet supplies in 2010 as pent-up demand begins to kick in. By our forecast, annual sales growth will rebound from 2.5% in 2009 to 4.0% during 2010, then climb back up to 5% in 2013 and 2014—an assessment that presumes much market dynamism moving forward.