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The Investment Engineers

Global Consumer Trends

Pet care market: well-prepared to weather the Covid-19 storm

- Market shows moderate but stable growth
- Time-tested resilience during recessions
- Covid-19 pandemic could become a tailwind

Broad-based socio-demographic shifts are among the structural changes that form the focus of our Global Consumer Trends strategy. They include the rise in pet ownership and increasing amount pet owners spend on their loyal companions. This trend has proved to be recession-proof in the past and is expected to remain resilient during the current Covid-19 downturn.

The market

The pet care market offers moderate but stable growth prospects, helped by a constant rise in pet ownership and increase in spending per pet. Currently estimated to be worth over USD 190 billion, researchers expect the global market to grow by an average of close to 5% per year between 2019 and 2025.[1]

The main drivers of this growth are the rise in pet ownership worldwide and a consistent increase in spending per pet, resulting from – for example – an increased spending on fresher and healthier food or the growing prevalence of zoonotic diseases,[2] which is driving up animal healthcare expenses.

[1] Global Market Insights, June 2019.
[2] Zoonotic diseases are diseases that can spread from animals to humans.

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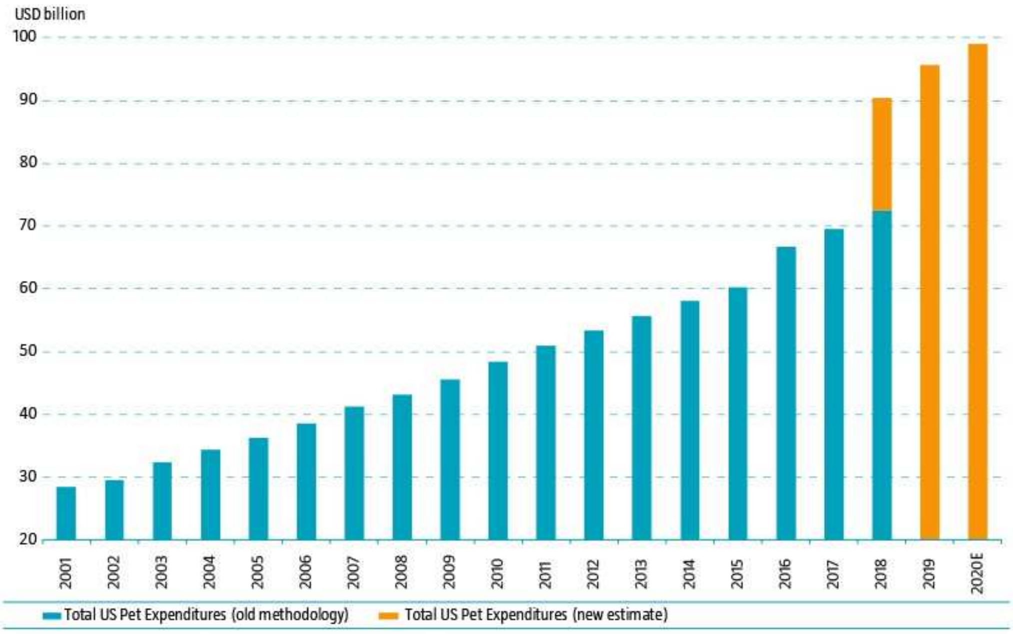
Another key factor is that owners increasingly treat their loyal companions like family members, with all the perks and benefits this brings. A survey carried out in November 2019 indicated that 88% of US pet owners say they consider their pet – be it a dog, cat, fish, bird or other type of animal – to be a member of the family. Over half (54%) said they buy Christmas gifts for their beloved animal, while 44% said they celebrate their birthday.[3]

In addition to moderate growth prospects, the pet care market also features a relatively resilient profile. In the US, for example, pet care spending continued to grow even during the 2008-09 financial crisis (see Figure 1). The sector encompasses a number of strong, defensive brands and, despite some recent mergers and acquisitions, remains relatively fragmented. Further consolidation is likely.

The US is by far the largest pet care market globally, with an estimated USD 95.7 billion spent in 2019, up 5.7% from 2018. This year, the US pet care market is expected to continue growing, albeit at a slower pace than in previous years. Industry experts estimate that pet-related spending will increase by another 3.5% in 2020 and reach USD 99 billion by the end of the year.[4]

Figure 1 | Total US pet industry expenditure



Source: American pet product association (APPA), February 2020.

Other smaller but significant markets include large developed European countries such as Germany, the UK and France. Outside the US and Europe, pet ownership levels remain much lower. However, some countries are catching up fast. For instance, the Chinese pet care market is expected to grow by over 14% per year on average between 2019 and 2025, helped by the rapid rise in pet ownership.[5]

In terms of products, the pet care market can be split in three main categories. The first comprises food and treats and represents approximately 40% of the total pet care market. The second comprises veterinary care and represents about 30% of the total market. The third is made up of other product and services, including for example training, grooming, pet sitting and over-the-counter medication.[6]

[3] Yougov, November 2019.
[4] Source: American Pet Product Association (APPA).
[5] Global Market Insights, June 2019.
[6] Based on US market breakdown figures, APPA, December 2019.

The players

Given the very wide range of products and services offered to pet owners, the listed players[7] in this market have extremely diverse company profiles, from large multinational pet food manufacturers owned by even larger conglomerates to more local service providers such as pet insurers and veterinary product delivery companies.

Pet food

The pet food segment is largely dominated by a small number of diversified multinational groups, including Nestlé, Mars, and Colgate-Palmolive. Even for such large companies, animal nutrition remains an attractive segment, offering both above-average growth and generally higher margins than human nutrition-related businesses.

For Nestlé, for example, pet care sales accounted for ca. 15% of total group sales in 2019 – an organic increase of 7% from a year earlier. This is compared to 3.5% organic growth for the group as a whole. Meanwhile, the division's underlying operating margin is well ahead of group average.

Over the years, these dominant players have actually been very active in launching new products and expanding their offerings, organically and through acquisitions, to both boost the sale of specialized pet food – as opposed to pets simply getting whatever owners could spare for them – and adapt to a changing demand from consumers.

Just like the human agri-food industry, the pet food sector has been undergoing a structural shift towards healthier, more varied and more environmentally friendly products. An ageing pet population and improvements in scientific knowledge on animal nutrition have also been major drivers of the change in pet food product offerings.

Despite the dominance of large players, changes in demand have also enabled new smaller players such as Freshpet, which specializes in higher end refrigerated pet food, and Blue Buffalo Pet Products, which manufactures a broad range of dry and wet premium pet food products, to enter the market. The latter was taken over by large food conglomerate General Mills in 2018.

Veterinary care

Veterinary care is also dominated by a small number of global players, most of which used to be part of larger pharmaceutical groups but were either spun off to form animal healthcare pure players or sold to other veterinary care groups. Examples of such companies are US-based animal health companies Zoetis and Elanco, which were formerly part of Pfizer and Eli Lilly (see Box 1).

Box 1: Animal health: from offloading to consolidating

Over the past decade, the veterinary care sector has seen several landmark corporate restructurings, as large pharmaceutical groups have offloaded their animal heath divisions. The pioneer in this area was Pfizer, with its IPO and full split-off of Zoetis back in 2013. More recently, in 2019, Eli Lilly followed a similar path and divested its animal health business by spinning off its animal health business Elanco.

Over the years, however, splits and spin-offs gave way to a different type of deal as the sector went through a wave of consolidation. In 2015, French pharmaceutical group Sanofi announced plans to sell its subsidiary Merial to Germany's Boehringer Ingelheim. The transaction was closed in 2017.

Another important deal was the sale of Bayer's animal health business to Elanco Animal Health, announced in 2019. Further consolidation is likely. The industry remains relatively fragmented and even the largest groups continue to lack a truly global footprint. For instance, while Zoetis is still the largest player globally, the US market accounted for 52% the group's revenues in 2019.

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Veterinary products and services range from drugs, diagnostic services and vaccines to food additives and medical devices. Other leading global players in the animal healthcare market include Germany-based Boehringer Ingelheim, US-based Merck Animal Health and France-based Vetoquinol and Virbac.

Smaller players will often specialize in specific segments. For instance, US-based Idexx Laboratories runs a worldwide network of veterinary laboratories offering a wide range of diagnostic-related products and services for pets and livestock. Another example is US-based Heska, which manufactures, develops and sells veterinary medical equipment and consumables.

Over the past decade, veterinary care companies have enjoyed moderate but relatively stable overall growth in a market characterized by a benign competition environment and relatively little disruption risk. Just as pet food businesses tend to be more profitable than human food activities, pet health care is also generally more profitable than human health care.

Other pet care players

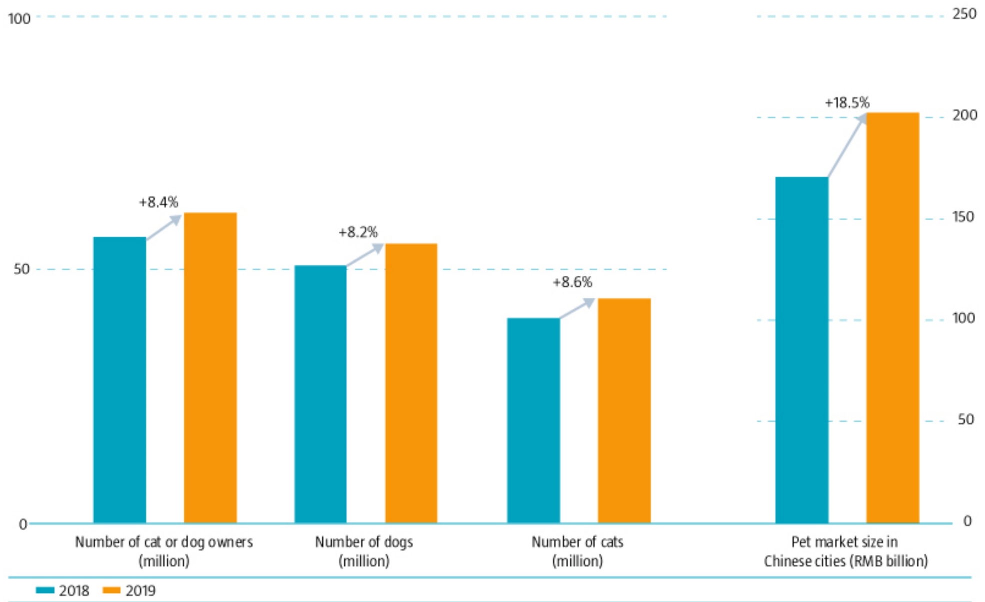
Besides food and veterinary firms, the pet care market encompasses a wide variety of other businesses. Among them, the largest group by far are the specialty retailers. This includes established players such as Petco, PetSmart and Pets at Home. These tend to be smaller and more local than large pet food and veterinary firms, though some have been able to expand way beyond their domestic market.

A number of specialty retailers have also emerged as online retail portals. These include US-based Chewy.com and Germany's Zooplus, Europe's leading online pet retailer. Finally, other listed players in the pet care market include a handful of pet services companies such as Trupanion, a leading pet medical care insurance provider.

Recent developments

In recent years, the rapid increase in pet care spending in large developed markets such as the US, the UK, Germany and France has also been accompanied a surge in demand from newer and more dynamic markets, particularly in Asia. Emerging countries such as China, South Korea and India have seen their pet populations grow rapidly, with pet care spending growing even faster in most cases.

Figure 2 | Chinese pet market overview



Source: Petfair Asia, 'Pet ownership in China 2019' report. The number of dogs, cats and cat or dog owners is shown in million (left hand axis). The pet market size is shown in RMB billion (right hand axis).

The pet population of South Korea, for instance, grew from 4.9 million in 2014 to 7.5 million in 2018, which is a compound annual rate of 10.8%.[8] Meanwhile, the number of cat and dog owners in China is estimated to have risen by 8.4% from 2018 to 2019, reaching 61.2 million.[9] While this may look like a large number, it is still only a tiny fraction of the country's overall population.

In many countries, millennials are increasingly seeing pets as a genuine alternative to children. In the US, for example, they represent the largest demographic group of pet owners for all pet types.[10] The APPA defines millennials as being born between 1980 and 1994. Although pets require some investment, they generally cost less and require less dedication than children.

Finally, another interesting recent development has been the emergence of new types of offerings, in particular from the online retail sector. Subscription deals for regular food shipments, such as Chewy.com's "Autoship" offering, and birthday gift boxes are a case in point. These have given an additional boost to the rise of ecommerce in the pet care segment.

Box 2: Will Covid-19 derail pet care spending growth?

As the Covid-19 crisis unfolds, the key question for investors is whether the increase in pet care spending will change. For now, the short-term effects of the pandemic have been mixed. Containment measures have forced many veterinary practices to remain closed for weeks. The closure of adoption centers in some countries could also slow the rise in pet ownership.

Yet the situation is not homogenous across geographies. While many European countries have kept their animal shelters closed for adoption, shelters in the US have remained open and been emptying as people confined to their homes have been adopting or fostering animals en masse.[11] A similar phenomenon seems to have taken place in other countries, including Australia.

These developments bode well for future spending as a higher proportion of the expenditure is incurred during the initial years, on things like vaccinations. This could be a tailwind for the veterinary sector, offsetting part of the initial disruptions. While it is still too early to draw conclusions, it is clear that the impact of Covid-19 will not necessarily be negative in the short term and may well be positive in the longer term, as well.

Meanwhile, Q1 2020 results painted a generally positive picture for the pet food segment. For Nestlé, for instance, pet care was the best-performing product category, with sales growing by close to 14%, which contributed to around half of the group's organic sales growth. While these numbers were likely boosted by stockpiling, they remain encouraging for the coming quarters.

Some online retailers also reported strong sales figures in the recent earnings releases. Zooplus, for instance, reported a 21% rise in sales, helped by increased demand from existing customers and a stable inflow of new customers. Relative to the same period in 2019, the company saw a similar number of new customers, despite a sharp reduction in efforts to acquire new customers.

Chewy.com has also seen an acceleration in sales since late February, from both existing and new customers. This translated into larger-than-usual basket spends and a surge in subscriptions. Chewy.com generates around 70% of its sales through subscription customers. All these developments suggest increased online penetration due to the pandemic, which may well become permanent.

The pet care sector therefore appears to be well-prepared to weather the Covid-19 crisis and its long-term growth potential remains intact, despite dire economic conditions. As Figure 1 illustrates, pet care spending has been resilient in the past, particularly during downturns. This was the case during the 2008 global financial crisis and the recession that followed.

[8] Petfair Asia, April 2019.
[9] Petfair Asia, 'Pet ownership in China 2019' report.
[10] Source: APPA, May 2019.
[11] Various US animal protection organizations and shelter networks, including The Humane Society of The United States, Best friends Animal Society and Muddy Paws Rescue, have been reporting a surge in adoptions on the back of confinement measures.

Conclusion

The global pet care market offers moderate but stable growth prospects, helped by a rise in pet ownership around the world and a consistent increase in spending per pet. Pet care spending has proved very resilient in the past, in particular during downturns. This was the case during the 2008 global financial crisis and the recession that followed.

Despite some disruptions caused by Covid-19 containment measures around the world, we believe that the long-term growth potential of the sector remains intact. The acceleration in pet-related ecommerce recently reported by some retailers on the back of pandemic-related confinement measures, which is consistent with the more general move towards increased digital consumption, illustrates some of the opportunites offered by the sector even during rougher times. In fact, the recent surge in ownership in some countries, driven by an increase in adoption and fostering by people confined to their homes, could even soon turn into a tailwind for the industry.

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