



# Pet Pampering Putting Bark into Spending

October 1, 2021

## Key Takeaways

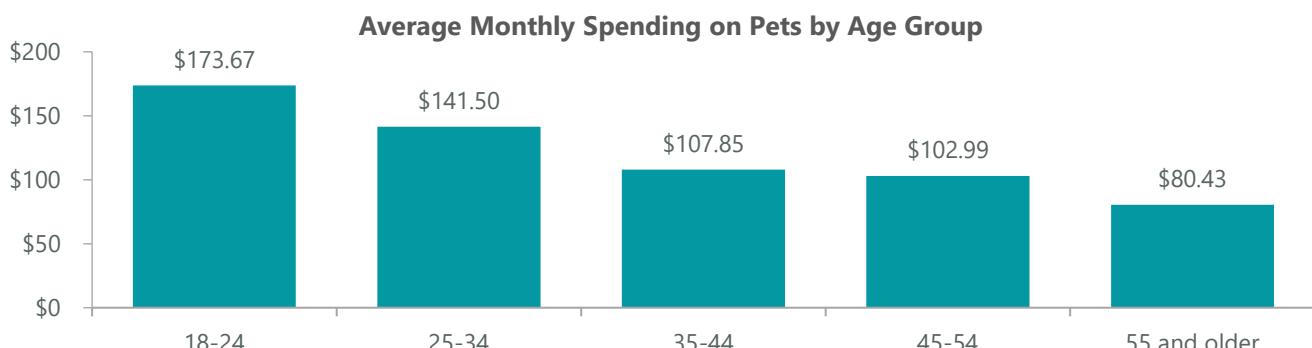
- ▶ The pet product and services industry has grown significantly over the last two decades as the humanization of pets has driven increased consumer spending.
- ▶ Shifts in consumer attitudes toward pets, which accelerated during the COVID-19 pandemic, have resulted in a greater demand for, and spending on, premium nutritional products, veterinary and pet services.
- ▶ Pure play pet companies have been major beneficiaries of these shifts in consumer demands for premium products, services, and convenience.

## Consumers Demand the Best for their Pets

Elevated pet spending and adoption during the COVID-19 pandemic helped spur the pet products industry to surpass \$100 billion in sales. In fact, the number of U.S. households with pets increased by 6% in 2020, and nearly one-third of existing pet households added a new pet during that time, according to Petco. And, more than a one-time, pandemic-induced phenomenon, this uptick in consumer spending on premium pet products and services continues a long-term industry trend we have been following since 2015.

While an aging population and more single-person and childless households explain some of the rise in pet spending, the greatest tailwind has been the increasing “humanization” of pets by what are known as “pet parents.” These consumers, spending on pets as on children, are willing to direct a greater proportion of their disposable income on their pets and are contributing to the demand for premium pet products and services. Millennial and Generation Z pet parents are spending a greater proportion of their income on pet items than other age groups, and as they become a greater proportion of pet owners, are helping to further accelerate this trend.

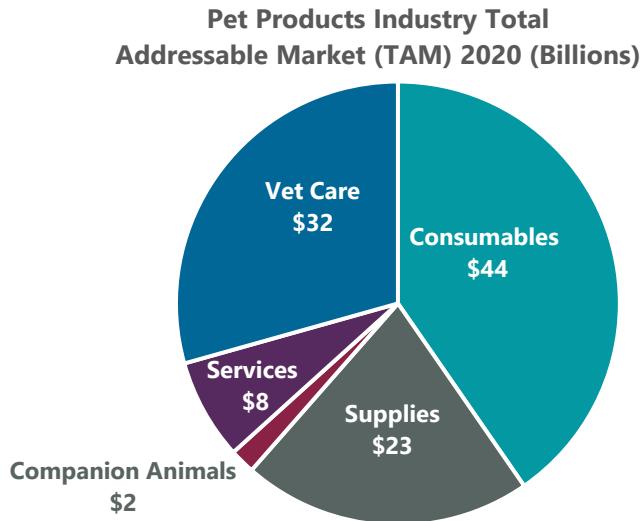
Exhibit 1: Younger Consumers Splurging on Their Pets



Data as of April 24, 2019. Source: Pet Age.

Retailers catering to the pet industry have taken notice of consumers' increased desire for higher quality and convenience. Greater pet humanization has entailed consumers mirroring the demand for healthier, organic and fresh food in their own diets in their purchasing decisions for their dogs and cats, affecting the \$44 billion pet food sector. Beginning with ClearBridge's participation in the 2015 IPO of Blue Buffalo, a premium pet food brand owned until its acquisition by General Mills in 2018, we have participated in the growth of a premium pet food market that has swelled to approximately 50% of the total market.

Exhibit 2: Pet Spending Categories Already Large and Growing



Data as of March 2021. Source: Packaged Facts and Petco internal estimates.

Companies are also increasingly incorporating technology and e-commerce to meet the demand for greater convenience. Chewy, which operates as an online-only retailer, significantly benefited from the closure of brick-and-mortar stores during the pandemic as well as the increased shift to e-commerce as customers desired more stay-at-home options. The company's ability to minimize costs, incorporate customer loyalty programs and set up repeat monthly delivery for recurring items has helped capture market share from more established competitors. By using technology to track customer trends, Chewy can send reminders to consumers that they may be running low on pet food or nutrition supplements. In addition, customers are finding it more convenient to have larger items such as heavy bags of pet food delivered straight to their door, rather than carry them out from retail stores.

For Chewy, which recently passed Amazon.com as the largest online pet retailer, catering to pet parents extends beyond mere operational efficiency to include best-in-class customer service. This includes personal touches such as packages including an additional bag of treats based on a customer's purchasing trends or handwritten notes from employees wishing pets a speedy recovery when an order includes new rehabilitation items or medication.

## **Increasing Demands for Premium Pet Health Services**

Discerning pet parents are more and more willing to spend to ensure their pets have access to a higher quality of health care. Veterinarians and pet health care service providers are responding by offering premium health care services such as preventative screenings, prosthetic devices and surgical services to extend pets' lives and well-being. IDEXX Laboratories has been a significant beneficiary of this increased demand, as the company manufactures diagnostic equipment and provides veterinary screening services. The increase in high-quality rapid testing and preventative screening is due not only to pet parents, but also vets looking to capitalize on greater consumer spending by keeping diagnostic services in-house. IDEXX's ability to provide both the software and hardware for these services makes it a critical partner for pet health care providers.

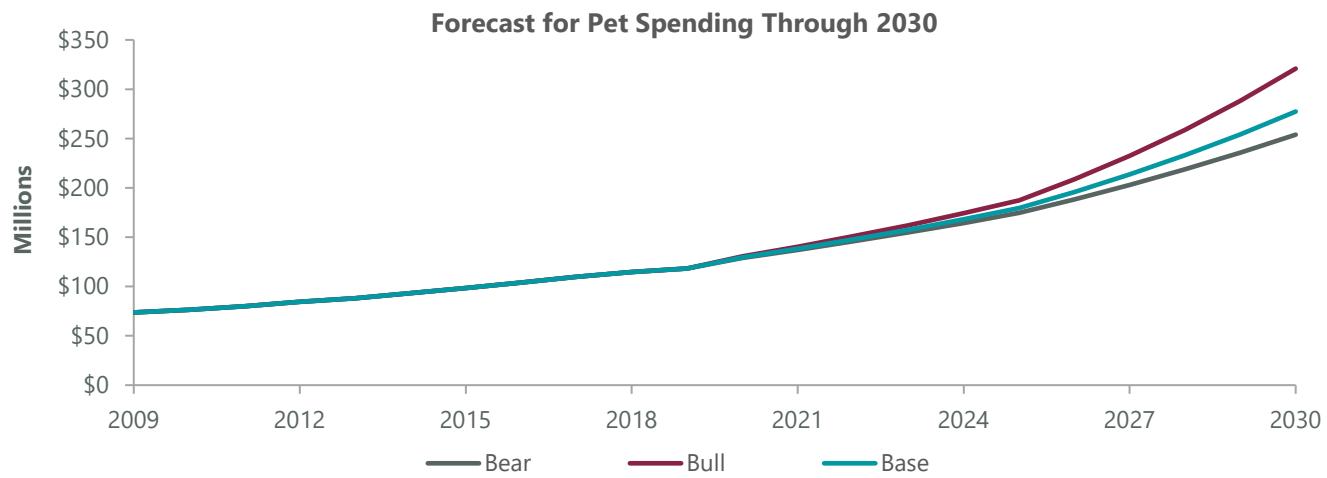
This increased demand for premium medical care has also led to an increase in both the amount of pet hospital visits and total cost of veterinary bills, creating a new market for pet health insurance. Over the course of a pet's life, veterinary expenses can range from \$500 to more than \$50,000, depending on the need for veterinary specialists, medications, emergency care and surgery. Pet owners have turned to companies such as Trupanion to offset the financial risk of costly procedures for illness and injury. Trupanion has been growing enrollment by a compounded annual rate of 35% over the last decade and continues to build on the positive long-term trends for pet insurance. With pet insurance having only a 1%-2% penetration rate among an estimated 183.9 million pets in the U.S., we believe Trupanion and pet insurance overall have compelling long-term growth prospects as veterinary costs rise.

### Transitioning from Retail Stores to Pet Service Destinations

The humanization of pets has led to a greater demand for other premium services, including grooming, day care and short-term boarding. Capitalizing on the increased demand for these services, pet retailer Petco has been redesigning its brick-and-mortar retail stores to include veterinary clinics, grooming stations and salons, day care facilities and pet hotels offering tiered quality levels of accommodations for short-term stays. We believe this transition toward a one-stop destination center creates sustainable long-term growth drivers as pets become more important members of U.S. households. Having multiple premium services in-store has helped to encourage greater foot traffic at Petco locations and provides more cross-selling opportunities for discretionary products and services.

Increased pet humanization has helped to create significant long-term growth prospects for the pet health care and retail industry. With 65% of 18-to-34-year-olds planning to acquire a pet within the next five years, pet ownership could climb by nearly 14% by 2030.

Exhibit 3: Pet Market Has Long Leash of Growth Ahead



Data as of April 7, 2021. Source: Morgan Stanley.

We expect the humanization of pets and increasing ownership among millennials and Gen Zs to continue to drive growth of the overall pet industry, especially in premium product and service categories. As shown in Exhibit 3, the growing importance of pets, combined with positive household formation trends, could see the pet health care and retail industry nearly triple in size by 2030.<sup>1</sup>

<sup>1</sup> Pets: A long-tail investment trend? Morgan Stanley. (2021, April 7).

## About the Author



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