

# NATIONAL POST

## **Pet food retailers deserve a pat; Baby Boomers fuel fat profits at PetSmart, Pet Valu**

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Pet food manufacturers have had a rough time over the widespread recall of tainted food this year. But for pet supply retailers, these are good days -- and the tail-wagging is likely to continue.

PetSmart Inc., which has a market capitalization of US\$4.4-billion and runs a chain of superstores in the United States and Canada, has seen its shares rise 27% over the past 12 months and 107% over the past five years.

Even better, Pet Valu Canada Inc., with a market capitalization of just \$110-million and much smaller stores in Ontario, Manitoba and the northeastern United States, has seen its shares soar 64% in the past 12 months and 1,500% over the past five years.

What explains the sharp rise? Part of the longer-term performance is due to a rebound from the big sell-off during the bear market of 2000 to 2002, but there is also an important trend at work here: Ageing baby boomers who face empty homes after their children leave are seeking companionship in the form of loveable dogs and cats.

According to the American Pet Products Manufacturers Association, U.S. consumers are expected to blow nearly US\$41-billion on their pets this year, up about 80% since 1998. Big bags of commodity-like pet food and run-of-the-mill dog leashes might form part of the tab, but increasingly consumers are splashing out on high-end gourmet treats, organic food, grooming products, pet attire and brand-name toys.

As a result, operating margins at pet supply retailers are far higher than at most regular food retailers. Loblaw Companies Ltd. and Wal-Mart Stores Inc. have margins of 4% and 5.9%, respectively. PetSmart's margin is 7.6%. And Pet Valu's margin leads the pack, at an impressive 9.2%.

Peter Puccetti, chairman and chief investment officer at Goodwood Inc., has bought a 19% position in Pet Valu, arguing that the retailer's small-store format and personalized service are the ideal ways to build a presence in the retailing sector. The company suffered during an unsuccessful U.S. expansion earlier in the decade, but has since improved its balance sheet by reducing its level of debt.

Pet Valu's shares trade at about 13 times trailing earnings, making them relatively cheap next to PetSmart's 22 times earnings. They are now 51% above Goodwood's average cost -- but Mr. Puccetti believes there are more gains ahead if the company directs its rising cash flow toward growth plans in Canada with more company and franchise-owned stores.

"The Canadian pet industry is highly fragmented and in need of consolidation -- much like the sporting goods industry was before The Forzani Group Ltd. undertook an aggressive store expansion and roll up of independents," Mr. Puccetti said in a note to clients this week.

"We believe the same growth and consolidation opportunities exist in the pet industry today."