



## **Investopedia Advisor April 16, 2008 Pets Are Profitable**

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April 16, 2008 (Investopedia Advisor delivered by Newstex) -- Pets. For many people they've become pseudo children. According to the **Mercanti Group**, two-thirds of American households own a pet while only one-third have kids. And in 2007 alone, pet owners spent \$41.2 billion on their animals, up 7% from 2006, according to the American Pet Products Manufacturers Association (APPMA).

We love our little friends, and apparently we're not going to let price get in the way of keeping them healthy and happy. Even a recession won't make much of a dent in sales, given approximately half of all spending on pets comes from households with incomes greater than \$70,000.

### **Who Profits**

The biggest beneficiaries of our love of animals are the pet food manufacturers. In 2007, they sold \$16.2 billion in food, 40% of the total expenditures for pets. A close second was vet care at \$10.1 billion and Supplies/over-the-counter medicine at \$9.8 billion. Pets are big business and several publicly traded companies are benefiting from these trends. We'll look at them in order of market capitalization, from largest to smallest.

· Petsmart (Nasdaq:PETM)

One of the original big box pet stores, Petsmart came to be in 1994. With over 13,000 products sold in over 1,000 stores in the U.S. and Canada, customers have services available such as grooming, day care and pet adoptions. In addition, Petsmart owns 20.5% of Medical Management International, which runs Banfield, the in-house veterinary clinics. In 2007, it made \$351.5 million in operating income on \$4.67 billion in sales. Earnings per share grew 46.6% to \$1.95 per share. Part of this growth was due to 95 store openings and same-store sales growth of 2.4%. In addition, the company bought 9.8 million of its shares in 2007 at a cost of \$315 million, or \$32.13 per share. Glenn Curtis, in his March 10 article Petsmart Neutered pointed out that its fourth quarter same-store sales were weak, up less than 1%; and management guidance calls for earnings per share in 2008 between \$1.35 and \$1.39 a share. While this takes the company back to 2006 numbers, long-term it could be a great buy, trading at 0.58 times sales . (To learn more, check out Use Price-To-Sales To Value Stocks .)

· VCA Antech (Nasdaq:WOOF)

The company is a leading provider of animal healthcare services in the U.S., operating over 435 animal hospitals. In addition to running the veterinary clinics, it also owns diagnostic labs, which is where the real profit is. If you look at the 2007 10-K , you will see that while the laboratory's generate just 25.6% of the total revenue, this translates into 41.7% of the operating profit . The trick to this business is to have enough animal hospitals in circulation generating lab tests. It's a symbiotic relationship. Revenue grew 17.6% and operating income 21.1% in 2007 to \$1.16 billion and \$233 million respectively. While some analysts are expecting an economic slowdown to hurt the company, Moody's recently raised its rating to 'positive'. While it seems the tepid economy will do some damage, it won't completely derail the company.

· Abaxis (Nasdaq:ABAX)

Abaxis manufactures veterinary blood analyzers that can be used right in the animal hospital as opposed to sending off the blood work to a lab. This provides immediate diagnostic care to the animals. Third quarter sales to the end of December, 2007 grew 17% to \$25.7 million and operating income 24% to \$4.4 million. Unfortunately, analysts expected third-quarter earnings per share of 16 cents, which they missed by two cents, part of what sent the stock spiraling down from \$33 at the end of January to \$23 today. It's not a cheap stock trading at five times sales, but it is a good company. That's according to Forbes Magazine, who awarded CEO Clint Severson, "Entrepreneur of the Year" in its October 29, 2007 issue; Forbes also named Abaxis the 11th best small cap in America.

### **Bottom Line**

The pet food recall in 2007 hurt many businesses including Procter & Gamble (NYSE: PG ) and Colgate-Palmolive (NYSE: CL ). More importantly, it showed how much pet owners care about their animals. Companies like Petsmart, VCA Antech and Abaxis survive and thrive because of this affection and loyalty. I can't think of a better group of customers, can you?

At the time of writing, Will Ashworth did not own shares in any of the companies mentioned in this article.