

## Q & A:

# Investing in Pets



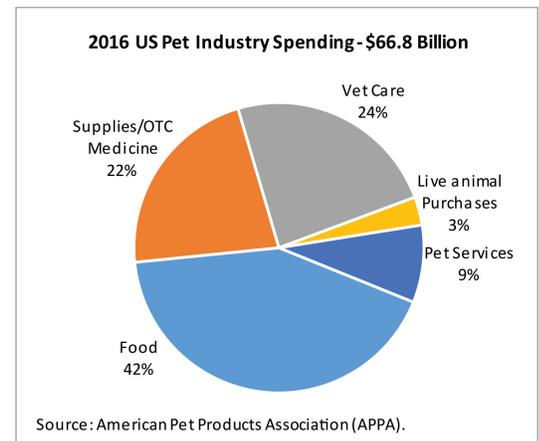
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**Q: We all love our furry creatures. Beyond the cute and cuddly factor, what attracts you to the animal health space?**

**A:** Though many think of the pet care business as a small niche, the size and growth runway of the market opportunity are truly compelling. In fact, total U.S. pet industry expenditures are expected to reach nearly \$70 billion in 2017, having grown at a 6.6% average annual growth rate since 1994. Pet food is arguably the most mature business in the pet world, with roughly 42% of total spend; however, vet care, supplies & medicine and pet services such as daycare are growing rapidly. While we like the growth outlook for the pet industry as a whole, we have focused our research efforts on the animal health sector, which includes the vet care, supplies and medicinal areas of the market. Our thesis relies on four key components: the “humanization of pets,” the “humanization of pet medicine,” a favorable regulatory backdrop and low cyclicity. We feel the combination of these factors paints a very exciting investment backdrop.

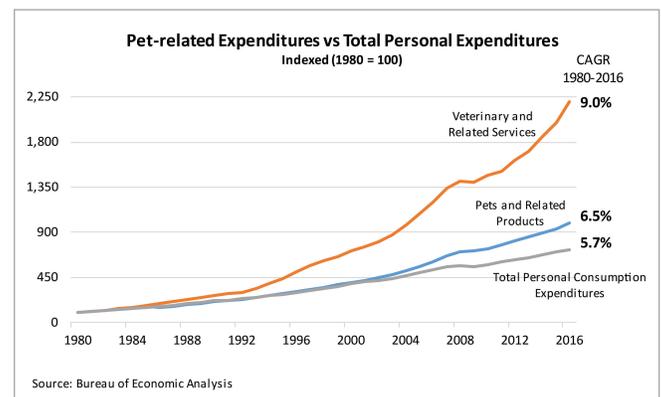


**Q: What is the “humanization of pets?”**

**A:** The “humanization of pets” is an industry term that describes the way pet owners ascribe human qualities to their pets, increasingly treating them like members of the family. A recent survey showed that over 95% of pet owners consider their pet to be a part of the family. As you might imagine from all of the pet photos on your social media feed, the millennial generation is taking the concept to the next level. According to a recent poll from a leading pet insurer, 12% of millennial respondents reported having ended a relationship because of a pet, while 40% reported having recently moved into a new residence to live in a more pet-friendly environment. Not every pet owner may be so head-over-heels for their pet that it affects their relationship status; however, it is clear that our pets are influencing our lives (and pocketbooks) in ways they never have before.

**Q: What is the “humanization of pet medicine?”**

**A:** The “humanization of pet medicine” refers to the increasing sophistication of veterinary care. In many ways, this is a result of the “humanization of pets” phenomenon just described. Put simply, pet owners are increasingly willing to spend whatever it takes to



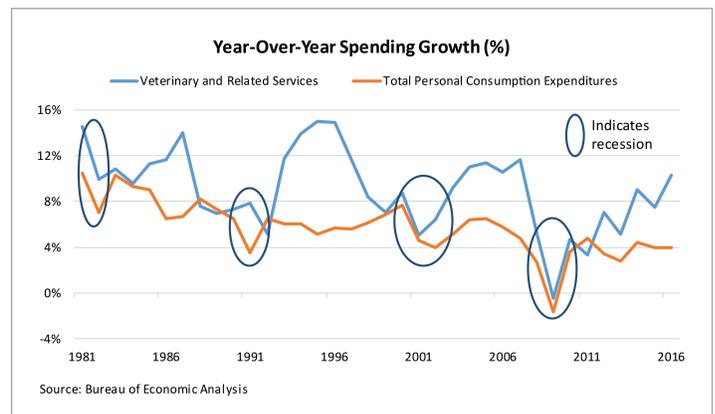
ensure their pet lives a longer and more comfortable life, in effect bringing human health therapies and specialties to the animal world that were previously unavailable. 10 or 15 years ago, pet owners would have never dreamed of taking their dog or cat to the dermatologist, whereas now this type of medical specialization is much more commonplace. Since 1980, spending on veterinary and related services has significantly outpaced total personal consumption in addition to general spending on pets and related products. We expect this should continue.

**Q: Why is the regulatory backdrop and industry structure more favorable than, say, human health?**

**A:** We might think of our pets as humans; however, the law does not necessarily agree. Though there are many regulations in place to ensure pet safety, there is just not as much regulatory red tape in regards to medical therapies or pharmaceuticals. For example, the approval process for a new pet medication takes roughly half the time and comes at significantly less expense relative to the human process. Furthermore, pet owners pay the majority of vet expenditures out of pocket, and are therefore free of the deflationary impact of consolidated re-imbursment networks such as managed care in human health. Both of these factors are positive for those developing new therapies and administering them.

**Q: What factors lead to the reduced cyclicality of animal health businesses?**

**A:** We just pointed out many of the differences between human and animal health; however, both industries are similar in that they exhibit muted cyclicality. Health issues do not just occur when times are good. Because of the “humanization of pets,” owners are much more willing to reduce spending in other areas in order to keep their pets happy and healthy. Throughout history, spending on veterinary services has not only grown faster than overall personal consumption, it has proven to be more resilient in recessions. This includes the most recent recession, where veterinary services spend grew at an average pace of 5.3% during the difficult economic climate of 2007-2010.



**Q: Based on these factors, how are you directing investments across your various investment strategies?**

**A:** Within the animal health arena, we have a diverse array of investments in exciting companies that have been significant contributors to recent results. Pet pharmaceutical manufacturers have demonstrated success either developing new therapies for old categories such as pain management or previously untreated conditions. The diagnostic equipment and services industry has been one of the faster growing segments within animal health, and we have benefitted from exposure to companies who supply diagnostic equipment and services. Another exciting category is pet insurance. Less than two percent of the U.S. pet population has insurance, whereas penetration levels are near 25% in the U.K. We think this presents a compelling long-term growth opportunity for the industry.

**If you have any questions about the topics covered in this handout, contact your Davenport Investment Executive or call (800) 846-6666.**

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