

# Demand for Premium Pet Food Boosts PetSmart's Competition

Companies: AMZN, CAG, CL, PETM, PETS, PG, SWY, TGT, VTX:NESN, WFM, WMT

May 16, 2013

## Research Question:

**How is PetSmart's business? What are its competitive threats, especially with regard to pet food?**

## Summary of Findings

- Demand for premium pet food is growing rapidly across all channels, and these higher-priced products have significant room for further growth given consumers' interest in trading up to healthier options for their cats and dogs.
- Twelve of 15 regional manager and store sources who commented on sales said [PetSmart Inc.](#) (PETM) has posted growth of at most 5% year to year. The basket average has held steady for one-half of these sources and increased slightly for the others. Hard-good sales at PetSmart are mediocre at best. An average 50% of these sources' customers purchase premium pet food, of which sales are at two to three times the level a year ago.
- PetSmart faces a legitimate, growing threat from traditional and nontraditional offline competitors in the premium and ultra-premium pet food categories.
- Traditional offline competitors' pet supply sales have increased 10% to 20% while their average basket size has also grown. Premium pet food dominates this channel, with a 30% markup and plenty of room for growth.
- Nontraditional offline competitors said they are not emphasizing their pet business. Still, demand for and sales of premium pet food have increased year to year.
- Online pet supply retailers also have experienced sales growth, but their business is focused more on hard goods than food, which is expensive to ship.
- Ultra-premium pet food manufacturers are not interested in selling to the mass channel, including PetSmart. Instead, they prefer to keep their luxury organic brands in the specialty channel and among loyal customers and retailers.
- [PetCo Animal Supplies](#) remains PetSmart's primary competitor, though regional brands like [Pet Supermarket Inc.](#) and [PetValu Canada Inc.](#) are increasing their presence in select markets. E-tailers do not appear to be a real threat to PetSmart.
- PetSmart's [microstores](#) have received good initial feedback and hold potential as a boutique version with higher-end food and hard goods.

## Silo Summaries

### 1) PETSMA RT REGIONAL MANAGERS

Sales are growing slightly year to year for seven of the eight sources who commented. Premium food purchases are the main reason for basket size increases, while other categories are flat at best. **Two sources said dog vitamins from GNC appear to be gaining a greater share of the basket.** Eight sources said anywhere from 20% to 70% of customer spending is on premium pet food instead of non-premium. **Significant room for growth exists for premium food.**

### 2) PETSMA RT STORE MANAGERS

Sales have grown slightly year to year for five of seven sources who commented. **Premium pet food is a tremendous growth area for all nine stores. Four sources said at least 50% of their customers buy premium pet food.** One source said dog vitamins are a more popular item, while two others said grooming services were a store staple. One source said Whole Foods is a growing threat in supplying premium food.

### 3) TRADITIONAL OFFLINE COMPETITORS

All four sources who commented on sales said year-to-year growth is in the 10% to 20% range. Four sources said premium food makes up 25% to 95% of food sales, with 30% being the average markup for premium. Premium food has become a dominant performer for these sources and has plenty of room for growth.

### 4) NONTRADITIONAL OFFLINE COMPETITORS

Sources did acknowledge greater consumer demand for premium pet food; one source now carries more premium products but on the lower end of the scale. Pet sales represent from 2% to 5% of total sales for two sources, and are growing 5% for one and in the double digits for another.

### 5) ONLINE COMPETITORS

All four agreed pet food offers slim margins and is expensive to ship, making hard goods, furniture, vitamins and other items the product of choice for e-tailers. PetSmart faces growing competition from Whole Foods, Target and Wal-Mart working to expand their pet product SKUs, especially in premium pet food.

### 6) PREMIUM PET FOOD MANUFACTURERS

These seven sources said they have no intention or desire to sell their products in the mass retail channel, including at PetSmart. Premium's share of the food market ranges from 6% to 60%. Two sources who commented on sales reported growth year to year.

	Premium Food Sales	Competition a Threat to PETM
PetSmart Regional Managers	↑	↓
PetSmart Store Managers	↑	→
Executives at Traditional Offline Competitors	↑	↑
Executives at Nontraditional Offline Competitors	↑	→
Executives at Online Competitors	↑	↑
Premium Pet Food Manufacturers	↑	↑

## Background

Consumers are becoming more inclined to spend more for healthy, holistic and organic food for their pets. Premium pet food is the No. 1 driver of business for pet stores, especially large chains like PetSmart and PetCo. It brings customers in who then also buy relatively high-margin hard goods such as toys, leashes, collars, treats and beds. Premium pet food is becoming more available in stores like [Whole Foods Market Inc.](#) (WFM) and [Target Corp.](#) (TGT), which could hurt pet stores' ability to maintain traffic and sales and could limit their sales of non-food products like hard goods.

### CURRENT RESEARCH

This report aims to determine PetSmart customers' purchase patterns of premium pet food and to assess PetSmart's competition from online and offline vendors, including nontraditional pet food retailers like Whole Foods. Blueshift employed its pattern mining approach to establish and interview 43 sources in six independent silos:

- 1) PetSmart regional managers (10)
- 2) PetSmart store managers (9)
- 3) Executives at traditional offline competitors (9)
- 4) Executives at nontraditional offline competitors (4)
- 5) Executives at online competitors (4)
- 6) Premium pet food manufacturers (7)

## Next Steps

Blueshift's next report will monitor sales of premium pet food throughout all channels. We will look at the different levels of premium pet food and learn what motivates consumers to trade up within the category. We also assess price point's role and the different pricing thresholds. We will monitor competition from nontraditional retailers and the related effects on PetSmart. We also will follow up with pet food manufacturers regarding sales in the mass channel, possible acquisitions from larger companies, and development of new brands for the ultra-premium market. Lastly, we will determine if pet food sales are becoming more common in the online channel.

## Silos

### 1) PETSMART REGIONAL MANAGERS

Sales are growing slightly year to year for seven of the eight sources who commented and are flat for the remaining source. The average basket size has increased in line with sales for five sources and remained the same as last year for two others. Premium food purchases are the main reason for basket size increases, while other categories are flat at best. Two sources said [dog vitamins from GNC](#) appear to be gaining a greater share of the basket. Eight sources said anywhere from 20% to 70% of customer spending is on premium pet food instead of non-premium. Significant room for growth exists for premium food. Customers do not revert back to lower-quality food; they only continue up the premium and ultra-premium food ladder. Premium food is two to three times more expensive than non-premium and growing at two to three times the rate of the previous year. Six sources were less enthusiastic about hard goods, calling sales steady at best, though none noted a drop-off related to increased spending on premium food. Branded and designer hard goods do better than generic lines. PetCo is PetSmart's clear rival, though Pet Supermarket and PetValu also are contenders. Three of six said e-tailers are a concern given the channel's deep discounting, but three said online competition was not an issue. Only one source spoke of any synergy with PetSmart.com. Four sources commented on the new microstores, including three who were excited about the model's sales potential.

Source	Sales	Basket	Product	Premium Food	Hard Goods	Competition	Online Comp
1	Flat	Flat, Food up		Success w/ premium, ultra-premium	Needs refresh	PetCo	
2	Ok	Up ~5% driven by premium food		PETM-exclusive brand up 2x yy		PetCo, specialty store threat	Compete online in dense population
3	Up ~5%	Up 10%, moving up value chain	Dog vitamins	20% is premium, room to grow	Slower than food		Online hit wall, shipping too \$
4	Up a few %	Flat, not trading up		66% is premium, 3x grow possible		PetCo, some specialty	
5	Up a little		GNC Dog vitamins	70% is premium		PetCo, some specialty	
6	Up a few %			20% is premium, lots room to grow	Branded toys good	PetCo, PetValu	Growing with cheap orders
7	Up	Spending is up		Lots of room to grow		PetCo, PetValu, Pet Supermarket	Not an issue
8		Up, upselling		Premium is differentiator		Pet Supermarket, PetCo	No comp, synergy with PETM.com
9				Non-premium brands as loss leader	Flat, potential in grooming	PetCo, Pet Supplies Plus	AMZN significant with 20% off
10	Up slightly	Up, natural food			Steady but not exciting		

## ➤ 1. Regional manager in the Southwest

Foot traffic is steady and premium food sales are trending upward in this relatively mature territory. Incrementally larger cart value primarily represents the increased presence of higher-quality food. Service seems to be under a little pressure, but this may be a seasonal fluctuation. Toys and other hard goods are neither suffering nor moving up market in line with food. Only PetCo poses a credible competitive threat in the region.

- Sales Trends
  - “I’d say we’re getting about the same number of people in the door as we were over the winter, maybe a few more but not really enough to put into percentage terms or change the mix of things we do.”
- Basket Trends
  - “They’re buying about as much, and the mix is moving up into higher-margin food, the private-label exclusives.”
- Premium Pet Food
  - “We find new ways to keep our people and give them more of what they want. It’s mostly food right now. We’re having great success with the premium and even the ultra-premium food. [Blue Buffalo \[Co.\]](#) is a real hit. Bison, the exotic proteins are doing well. Grain-free is a hit. ... Food mix is definitely moving up into that area.”
  - “As food moves up, our retention should improve. People aren’t as loyal to stores as they are to brands. Offer them a brand they like at a cheaper price, they’ll drop their store and go to you. Offer them a brand they like that they can’t get anywhere else, they’ll stay right where they are. And as awareness of premium pet diets expands, you can actually get new people to come in. We start getting new faces, and they come in month after month.”
- Hard Goods
  - “Toys are about due for a department refresh. They’re not doing badly, but they’re not running to the cash register on their own, either. We haven’t made an effort to move them up with the food.”
- Competition
  - “PetCo is really the only other chain in this city. Between us, we’ve outlasted just about every independent pet supply store. We have a similar profile to PetCo in this city in terms of reach and size, but we have the advantage in terms of exclusive products to get people to choose us on a recurring basis. If you’re a PetCo customer, maybe you’re also a PetSmart customer, but if you’re a PetSmart customer, odds are better that you’re with us for the long haul.”
  - “Nobody starts out a dedicated pet parent and then spends less and less as your pet gets older and becomes more of a dear member of the family. You spend more. You seek out specialized food.”
- Miscellaneous
  - “Grooming and boarding seem to have slowed down a little. That might be people allocating limited pet budgets toward better food for happier, healthier, better-looking pets, so they don’t need quite so much professional attention to stay happy and healthy. Or maybe there just isn’t enough cash left. I think there’s still plenty of cash there, and it’s just the winter weather. People aren’t traveling as much this time of year so don’t have to board as much.”

I’d say we’re getting about the same number of people in the door ... but not really enough to put into percentage terms or change the mix of things we do.

*Regional Manager, PetSmart  
Southwest*

## ➤ 2. Regional manager in the Northeast

Foot traffic was flat at best throughout the first quarter although shopper enthusiasm picks up as the weather improves. Although shoppers are converting to higher-grade food, overall cart growth is up only 5%. Service is a sore spot. Competition is unusually intense given the persistence of strong independent stores as well as PetCo. Online is a threat in densely settled areas.

- Sales Trends
  - “It’s been OK. The winter really dragged, so people put off a few car trips in February or March that they would otherwise have been out looking for a new dog bed or even a new member of the family. Now that the snow is finally melting, we are seeing more people come in. Now we’re back where we thought we were going to be.”
- Basket Trends

- “Overall we’re probably about where we were last year despite the [increase in] premium food sales, maybe 4% to 5% ahead on a per-cart basis. Premium is doing well; everything else is not exactly keeping up. Hard goods are not keeping up. Grooming is off because who wants to get their dog bathed and cut and then go out in the mud? The salon is still a vital part of our store.”
- Premium Pet Food
  - “The exclusive brands of food are a real miracle. [Simply Nourish](#) is a real hit, and especially the puppy brands are amazingly popular. The Simply Nourish side of the dog food aisle has doubled in unit sales year over year. It’s not the biggest part of our business, but it is the biggest place I can point to as a big growth area.”
  - “Very few existing customers are moving all the way up from ‘value’ brands to the exclusive brands. We are trying to get people to move gradually up the ladder, not jump straight to our top brands.”
- Competition
  - “This is a part of the country where I think PetSmart is more on the defensive. We have the better locations, but there are more PetCo stores. We have to fight harder for our piece of the dedicated pet store shopping trip.”
  - “There’s a long tradition of independent retail here that just doesn’t exist in the Midwest or other places. The ones that are still here tend to be higher-end, more boutique-oriented and so have always been strong on diet and nutrition and premium products. They have a real, deep hold on their customer base, sometimes for generations.”
  - “I’m dealing with local competitors above us and PetCo below. We have to push our brand to stay relevant. I still have to advertise and promote our baseline product line as superior to what you can get elsewhere.”
- Online
  - “Because we’re in such a heavily urban area, there’s a significant number of people who don’t actually get in the car and drive to the shopping center PetSmart every month. They buy food and litter online and have it delivered, so we’re also competing harder against online.”

Overall we’re probably about where we were last year despite the [increase in] premium food sales, maybe 4% to 5% ahead on a per-cart basis. Premium is doing well; everything else is not exactly keeping up. ... The Simply Nourish side of the dog food aisle has doubled in unit sales year over year.

*Regional Manager, PetSmart  
Northeast*

### ➤ 3. Regional manager on the West Coast

Store traffic is steadily increasing. A shift toward higher-end food and exclusive products is boosting the basket average. Premium food already accounts for about 40% of the category’s dollar sales but only 20% of unit sales. Additional migration is possible. Vitamin sales are strong. Increased household spending on food is not cannibalizing hard goods. As hard goods shift up market into more durable products, the category is essentially cannibalizing itself. Online has penetrated as far as it can. “Showrooming” is not a concern as long as proprietary and exclusive brands dominate the product mix.

- Sales Trends
  - “We’re growing our daily floor traffic by 2% to 3% over last quarter, maybe 4% to 6% over last year. That’s not awful given the reality that local chains are very deeply rooted in the community and PetCo is always in the mix. Plus, we have a substantial population up here that loves to shop online.”
- Basket Trends
  - “Our average transaction is up maybe 5% over the end of 2012 and 10% over where we were last spring. I’m much happier with that number because it means the shoppers we have are deepening their relationship with us. A lot of that is

Our average transaction is up maybe 5% over the end of 2012 and 10% over where we were last spring. I’m much happier with that number because it means the shoppers we have are deepening their relationship with us. A lot of that is buying up the value chain, moving away from supermarket or mass-market brands into natural proteins and more gourmet recipes.

*Regional Manager, PetSmart  
West Coast*

buying up the value chain, moving away from supermarket or mass-market brands into natural proteins and more gourmet recipes. Otherwise, everything is probably growing at a much more general rate.”

- Product
  - “People are buying vitamins; GNC does very well for us and is a new category.”
- Premium Pet Food
  - “Premium food is rapidly expanding. People are waking up to the importance of what you actually put in your body as a major factor in health and longevity. If you won’t eat factory meat because those animals are pumped full of hormones and preservatives, why do you feed those same chemicals to your beloved pets?”
  - “About one in five of our customers has shifted to what we call the ‘natural formulas.’ They tend to be two to three times as expensive per pound, so that’s about 40% to 50% of our food business now.”
  - “Food is dynamic for the first time since I came here. We’re selling the same number of bags and filling the same amount of aisle space, but now each bag is double or triple the price. And we can still convert that other four out of five customers so I don’t see this slowing down anytime soon. Once they change they don’t change back. The migration goes one way.”
- Hard Goods
  - “In general, the non-food aisles are also moving up market but more slowly than the food. I wouldn’t say the food is taking so much of people’s budgets now that they can’t buy pillows, shirts and toys. I would say that as we get a more upscale crowd, they don’t want a lot of clutter or trash that’s going to go into a landfill in a week and need to be replaced. They’re buying more durable accessories in much lower quantities.”
- Online
  - “E-commerce has hit a wall on pet food. This is a product sold by the pound, and it’s expensive to ship.”
  - “Besides, how do you know which 50-pound bag to have dropped off at your door in the first place? That’s why people come in to our store in the first place.”
  - “We are not really worried about people coming into the store, getting our advice and then driving that sale to an online competitor. Our important products are exclusives. You can’t get Simply Nourish at [Wal-Mart \[Stores Inc./WMT\]](#) or Walmart.com. It is unavailable on [Amazon\[.com Inc./AMZN\]](#). It doesn’t even show up on the PetCo site. You can only get it from us or PetSmart.com. We can recommend it in-store, and then you might go home and buy it from us online. That’s OK.”

“About one in five of our customers has shifted to what we call the ‘natural formulas.’ ... That’s about 40% to 50% of our food business now. ... We’re selling the same number of bags and filling the same amount of aisle space, but now each bag is double or triple the price. And we can still convert that other four out of five customers so I don’t see this slowing down anytime soon.”

*Regional Manager, PetSmart  
West Coast*

#### ➤ 4. Regional manager in the mid-Atlantic

Overall sales have accelerated slightly as the chain’s new product mix builds traction. Food is by far the biggest growth driver in dollars. The process of converting U.S. pet owners to premium food still is in the very early stages. Most food sold in local PetSmart locations is weighted toward proprietary or exclusive brands, leaving more bulk-oriented food to the grocery and big-box channels. Local competition is limited to PetCo and independent retailers, all of which are suffering erosion in their core grooming and boarding business.

- Sales Trends
  - “We’re doing pretty well. Overall transactions are up a few percent over last year, and sales are up maybe a little more. We’re not so much introducing people to the PetSmart family anymore so much as giving them a reason to come in if they haven’t visited in a while. New products, new promotions, new exclusive products to try out and hopefully get them hooked.”
- Basket Trends
  - “Our actual unit sales haven’t gone up much, so we’re not feeding a lot more dogs and cats. And most of the dogs and cats we’re feeding are still on relatively mass-market brands, \$15 for a 20-pound bag. That means there’s still a lot of dogs and cats out there that could maybe trade up to a \$13 for a 5-pound bag sort of diet. That’s a lot of potential growth in our average cart.”

- “Going from \$15 to nearly \$60 for the same number of meals is not going to be possible for everyone.”
- Premium Pet Food
  - “Natural food for pets has barely gotten started. Premium food can easily cost three, four times as much as no-brand generic chow, so bowl by bowl that’s maybe 1% to 2% of all dogs and cats eating premium. I think we can easily double or triple that adoption rate every year, which means pulling people out of the grocery store and into the pet food store for the brands.”
  - “More than half our business is food, which is more or less what you’ll find elsewhere in the country, and in this territory probably two-thirds of our dollar sales in food is from channel exclusives, which are the boutique brands that otherwise you have to buy straight from the vet or your dog daycare.”
  - “You can’t buy this food at Wal-Mart or your local grocery. We’ll be able to capture that huge chunk of the market that previously had no reason to come in. The specialty channel grows even if the number of dogs and cats in this country doesn’t change one bit.”
  - “The bulk bags are barely a quarter as profitable as the natural brands on a per-pound basis.”
- Competition
  - “In the specialty channel, things get interesting. We have about as many stores in this metro area as PetCo; only, ours are better clustered around the city center, the big shopping districts. The PetCo locations are out anchoring various suburbs and are more of a hard ‘destination shopping’ sort of weekend trip.”
  - “We have some local independent stores here as well, but they’re really more dog daycare, grooming or veterinary clinics with a food retail component. They compete with us directly because they can sell the same premium brands, but we have a few advantages. We can obviously stock a bigger swathe of the premium brands than any clinic or pet salon. We have thousands of square feet of floor space.”
  - “They depend on pet grooming, veterinary services or boarding as their bread and butter. We are getting involved in those businesses because, among other things, it hits them where they live. Sooner or later, we’ll be the place people bring their pets for grooming, vet, boarding, and then they’ll be more inclined to buy their natural food from us as well.”

**“In this territory probably two-thirds of our dollar sales in food is from channel exclusives, which are the boutique brands that otherwise you have to buy straight from the vet or your dog daycare. ... The bulk bags are barely a quarter as profitable as the natural brands on a per-pound basis.”**

*Regional Manager, PetSmart  
Mid-Atlantic*

## ➤ 5. Regional manager in the Southwest

Sales and foot traffic trends are positive and momentum is good. PetSmart still is finding organic expansion opportunities, even in this relatively mature territory. The process of shifting food up market may take a generation to fully exploit but will be extremely lucrative for the winners. Prototype small-footprint stores will focus on service and premium food, essentially taking over independent boutique operators’ role. Hard goods and bulk food are peripheral categories. PetCo will remain the only serious competitor on an international level unless smaller chains will engage in massive consolidation in the near term.

- Sales Trends
  - “Visits and sales are both pushing higher and should continue to do so for the foreseeable future. We’re in line with the national trend, up a little both quarter to quarter and year over year.”
  - “We ramp up slowly. People who have pets already know we’re here. Pet ownership itself is pretty flat, so our goal is to win the households that already buy a bag of food every month.”
  - “What’s exciting to me is that we are still finding places that could benefit from another PetSmart. We don’t have all those households yet. We maybe have 10% of that audience so there’s still a whole lot of room to keep building out.”
- Premium Pet Food
  - “We are able to build out because we’re selling what is essentially an all-new product, which is all-natural, nutritionally balanced, healthy food for dogs and cats. Nobody has sold this product before on a national chain-retail level. It replaces the old, familiar Purina [Nestlé S.A./VTX:NESN], Meow Mix

[ConAgra Foods Inc./CAG] and so on, which is basically a human food by-product sold by processors into the grocery channel. Every cat on Simply Nourish is a cat that no longer eats much Meow Mix.”

- “Around 70% of my food business is natural food and 50% of my business is food, so that’s a big piece of my business. But I read somewhere that PetSmart and PetCo between us only have something like 30% of the U.S. pet food business, so you can see how much room there is to convert those cats.”
- “If there’s room in the family budget, we’re happy to feed that cat on \$25 or \$30 a month than on \$10 to \$15 a month. ... A lot of our most loyal pet parents are empty-nesters and retirees and have the money to spare. ... The key is being that person who sells the \$30 food and not so much the one who sells the \$10 case of [Nestlé’s] Fancy Feast.”

#### ▪ Competition

- “The people in position to sell that \$30 cat diet are ourselves, PetCo and other specialty stores with expertise and in-depth knowledge. Our associates are trained and truly love the animals.”

#### ▪ Microstores

- “The small-scale stores we’re opening are designed to live in that pet boutique world. With the floor space available, they’re really pet service centers with a boarding area, an adoption area, immunizations, trim and nails. There is a retail floor, but it’s no-nonsense: all exclusives, food you can’t buy at the grocery store, the fun hard goods at all price levels.”
- “The microstore’s job is not to bring the high-end PetSmart experience to a small town or crowd out a PetCo. It’s not even really there to bring all-natural pet food to people who can’t get it any other way, because there’s always a way. Its job is to round up some of the roughly \$35 billion in non-food pet spending that’s out there, most of which is actually on the service side. If we nail that down, we become the point of recommendation on the food side as well and so can circle up that business as well.”
- “The microstores do not have much in the way of generic toys, bowls or beds, and they definitely won’t have the food you get at the grocery store or farm supply yard. Those are really side businesses for us. Our future is in branded designer bowls, [Martha Stewart](#), character toys and things like that. And bulk food is heavy and cheap, so it’s actually more expensive to work with than it’s really worth.”

The small-scale stores we’re opening are designed to live in that pet boutique world. With the floor space available, they’re really pet service centers with a boarding area, an adoption area, immunizations, trim and nails. There is a retail floor, but it’s no-nonsense: all exclusives, food you can’t buy at the grocery store, the fun hard goods at all price levels.

*Regional Manager, PetSmart  
Southwest*

## ➤ 6. Regional manager in the Northeast

Premium food is definitely the strong spot of PetSmart’s product line and a major driver of store traffic. Consumers view increased spending on food as a way to add value to their pet relationships and to minimize veterinary and adoption costs. Character toys and designer accessories also are selling well. More generic hard goods lines are under pressure from online and offline competitors. The new generation of smaller PetSmart stores will emphasize higher-priced, exclusive products.

#### ▪ Sales Trends

- “Overall we’re seeing a few percent more people coming in, mostly to look for healthier food. Our advantage over a traditional mom-and-pop pet store is that we stock everything good and have space to display it.”

#### ▪ Product

- “The GNC vitamins are doing amazingly well, by the way. I don’t know what category to put that in, but having a multivitamin for a dog is the best thing. And it’s actually cheaper than some of our ultra-natural food.”

#### ▪ Premium Pet Food

- “Higher-quality food is becoming a craze. People are justifiably upset about the toxic mess that you can get in pet

The GNC vitamins are doing amazingly well, by the way. I don’t know what category to put that in, but having a multivitamin for a dog is the best thing. And it’s actually cheaper than some of our ultra-natural food.

*Regional Manager, PetSmart  
Northeast*



food from China in particular, so they're looking for American-made and all-natural products. It's gotten maybe a 25% boost around here over the last year as our more conventional food slowly shrinks its presence on the aisles."

- "First, you have the basic fear that processed dry food is bad. Then you have the investment motive where people are feeling a little flush and want to spend a little more on their pets, so they go with food. Maybe it'll live a longer, healthier life."
- Hard Goods
  - "I like the [Disney](#) princess types of toys. They're great for empty-nesters. Martha Stewart is doing well. These are the nicer sorts of hard goods, better colors, more attractive and distinctive and fun."
  - "The conventional leashes and leads and balls you can buy at Wal-Mart are not really stunning me, but then again, you can buy that stuff at Wal-Mart."
- Competition
  - "Around here we have a lot of PetCos to contend with. They're a slightly lower-cost chain, so they get more of the big bag and less of the premium blend business. We also have a dense population of Pet Valu stores. That's a lower-frills chain trying to compete on price."
  - "You can buy cheap chow at Wal-Mart or [Safeway \[Inc./SWY\]](#). Those customers don't really come into our stores for it because we're not the low-cost retailer."
- Online
  - "Online is also an issue for my people because it's a relatively high-tech corridor with high traffic congestion. People will go to the shopping center, but they won't be happy about any extra trips when they could get the big bag for a cheap price per pound, no sales tax, free shipping. They're welcome to it."
- Microstores
  - "We are unveiling some smaller stores that are nothing but our greatest hits—the popular premium food, the fun designer accessories. Nothing you can buy across the street at PetCo. Nothing you can Google and get at whatever website. ... These stores are rolling out in the edges of our territory to sort of mark a line in the sand against Pet Valu's possible expansion and establish ourselves as the good pet food people."

## ➤ 7. Regional manager in the Southeast

This region is thriving in the relative absence of organized online or offline competition. Although once-exotic food choices have moved toward the mainstream, market penetration is nowhere near universal. This creates opportunities for the specialty channel to deepen its hold on the overall pet basket. Hard goods are a secondary growth driver but remain a significant profit center. Store-level management is a bit reluctant to embrace services. The microstore concept is exciting as a way to accelerate the process of moving the pet category up market on a leaner capex basis.

- Sales Trends
  - "We are booking more transactions quarter to quarter and year over year. You can get the comps from headquarters, but I can say the direction is upward."
- Basket Trends
  - "Basket is deepening a little per transaction, so we're bringing in more people and each one is spending more."
- Premium Pet Food
  - "There is still a lot of room here for everyone to convert to healthier blends. That means bringing 80% to 90% of pet parents into the pet shop channel, which means our job has really only gotten started. It gets easier as word gets out. People used to think their neighbors were crazy for feeding dogs and cats real meat, but now we seem to be at the tipping point."
  - "Once you shift up, you generally keep nudging the basket upward for awhile. And sales are recurring."
- Hard Goods
  - "Everything but food is a different story because your dog bed does not get used up every month."

**There is still a lot of room here for everyone to convert to healthier blends. That means bringing 80% to 90% of pet parents into the pet shop channel, which means our job has really only gotten started. ... But now we seem to be at the tipping point.**

*Regional Manager, PetSmart Southeast*

- “I love the hard goods because it gives us a new upsell for people who are at a plateau in their food cycle. If you’re happy with the dog’s diet, that’s great. If you have an extra \$30 burning in your pocket when you come into the store, have you looked at the dog beds? Designer and branded toys and furniture and accessories ride the premium food wave. ... That stuff tends to have better margins though, about on par with the ultra-premium food. It’s just that we can’t make a lot of recurring sales to the same pet.”
  - “My managers are a little perplexed by how service fits in. It eats a fair amount of store space and can be very expensive in terms of labor. I keep telling them service exists to keep them coming in to see the new home grooming tools and the glossy-coat vitamins.”
  - Competition
    - “In other parts of the country you have it where PetCo, some local chain or even a website takes the outreach you do on natural pet diets and sells their own knockoff formulas. We’re lucky enough to be able to eat more of our own success around here.”
    - “Locally we have PetCo but as a junior competitor. We were here before them and had our pick of locations. Then we have Pet Supermarket tiptoeing around our southern border and Pet Valu hugging their mid-Atlantic stronghold to the north.”
  - Online
    - “The websites are not really an issue. Maybe everyone in the world except our customers is buying food online and having it shipped. Somehow I don’t think so because I look at these sites and they all look so small, like mom-and-pop stores, only with no store. How much volume can they possibly be doing? And, of course, the shipping and discounts must eat them alive.”
  - Microstores
    - “I love the idea of going back to under 8,000 square feet. We know what works. The superstores have taught us what moves and what doesn’t. Why not fill out our map with small stores stuffed with what works and leave the rest to the nearest superstore, or even abandon that business entirely? The small stores should be cheap to build, efficient to staff and supply and help us reach people who would otherwise go to the supermarket instead. I’m getting two new stores in the next few months. Neither is above 12,000 square feet.”
- **8. Regional manager in the Southeast**
- Although Pet Supermarket is expanding aggressively as a low-end competitor, more established specialty chains are using product exclusives to move up market and avoid price pressure. Foot traffic is holding up, and the basket average has improved slightly. Food and pet vitamins are an obvious growth market. E-tailers are not a threat.
- Basket Trends
    - “We are keeping our people despite Pet Supermarket. Because we don’t have the match-your-prices pressure, we can bump up the cart a little, very slowly but it’s sticky. Month after month, we can try to add a bottle of vitamins or a better grade of food or some treats or a learning toy to the regular customer’s spend. It’s gradually catching on.”
  - Premium Pet Food
    - “Food is doing well. Premium is easily half our food business now in terms of unit sales. GNC is doing well. Our customers are getting older, and they’re eating better on doctor’s orders. They watch their diet and want to make sure they do better for the pets they have to feed as well.”
  - Competition
    - “Pet Supermarket ... is opening stores here and around the region. We and PetCo are fairly evenly matched in terms of coverage, and Pet Supermarket has tripled its presence in my territory to roughly match either of us. I’m not really worried. It’s practically a whole other market they’re in.”
    - “Pet Supermarket brings people in by offering decent bulk food at a lower price than you might get at a big-box store like Target or at the supermarket. Then they sell the bowls, leashes and live animals as impulse buys when you’re already in there for your bargain. That’s not what we do at all. We sell things you can’t get at Target at any price: premium all-natural food, designer accessories. We’re happy to match anyone else’s prices to get a sale on things we both carry. They can’t match our price because they don’t have it.”
    - “PetCo is a little less far along in terms of exclusives. Maybe they want to be the national low-cost store. That’s OK. I think they have a little less room in the stores to try new things.”

- Online
  - “Websites are not really competing with us. I think they might compete with Pet Supermarket but not us because, again, we have the different product line. People might search for ‘premium cat food,’ but we come up and then people who try our brand will keep ordering from our site or come into the store when they run out.”
  - “We have loyalty and can depend on customers coming back when they find something they like. The sites can’t. Even a happy customer will go elsewhere for a few pennies less.”
  - “We also have on-site knowledge and service. You can’t have a website give your dog a flea treatment. You can’t ask a fellow pet parent for advice on a website and be able to trust the answer. That’s the reason Amazon, for example, is just not a credible force in this business.”

## ➤ 9. Regional manager in the Midwest

Pressure from entrenched and emerging regional competitors is forcing pet supply retailers to promote proprietary products. Premium food sales are strong but still require work in generating consumer interest. Non-exclusive food brands are becoming less profitable as wholesale and other input costs rise while online and offline pressures frustrate efforts to raise prices. Hard goods are hit-or-miss. Service is a potential growth and loyalty driver, but is more of a defensive business for now. Although PetSmart has room to fill in its footprint with large and small stores, its small stores may not be a good way to capture new markets.

- Pricing
  - “The whole ‘slash prices to make a name for yourself’ approach is everywhere. The food marketplace is honestly so crowded that you find a lot of closeout lots as flavors and brands sputter and die. At least my own website isn’t going to undercut me.”
  - “The thing about mass-market food is that everybody who isn’t holding their price is racing to the bottom. Raw and processed protein and grain have gotten more expensive over the last year or so. Prices have dropped. That means this whole category of products is becoming less profitable to sell.”
- Premium Pet Food
  - “The premium food brands are an obvious way for us to stand out from the others. We do a lot of work with our service partners to make sure that the value propositions of various types of natural diet for pets are clear and circulating within the local area. We do more taste tests at local dog shows, dog parks and so on.”
  - “We will use the non-premium brands as a loss leader. It drives the unit price down a bit, but the margins are already low on those products. We are constantly looking over our shoulder at the websites offering insane prices.”
- Hard Goods
  - “Hard goods are OK. It’s a steady business. Not many people come in just to pick up a dog pillow, but they’ll add a sweater or a toy or a ball to the cart. Novelty sells. The designer lines have been iffy. Martha Stewart did all right initially but is fading out fast. [Toys R Us](#) is, frankly, the kiss of death. I’m eager to see whether Disney is another quick hit or a steady seller.”
  - “We are hoping service will become a bigger piece of our stores, purely because it’s another way to build long-term relationships and loyalty if nothing else. You get your dog trimmed one place, you come back next time. You pick up some food or a bottle of vitamins while you’re there because that’s what does better for the coat. You definitely do not shop around.”
  - “Services is also a way to expand our overall business by absorbing independent operators. This is such an extremely cottage-oriented side of the pet industry.”
- Competition
  - “We are in a densely populated area in terms of other chains. This forces us to keep advertising ourselves with loss leaders and building awareness of why our exclusives are so good. We think less in terms of store traffic gains and more in terms of share. Are we bringing them in away from one of the other chains? Are we getting them to come back? On that basis, we’re not losing ground.”

Amazon is becoming a significant player throughout the pet market at discounts of 20% to 30% below retail. We can’t compete with that, so we don’t. We sell what only we can sell and leave them to fight everyone else for what’s available everywhere.

*Regional Manager, PetSmart  
Midwest*

- “I think we’re actually the fourth-biggest chain in this area behind PetCo as well as Jack’s Pets and Pet Supplies Plus. The density has made it hard for us and PetCo to build out here to our usual extent because we’re not only building against each other but against several Midwestern chains that were here first and are still big on the scene.”
- Online
  - “Amazon is becoming a significant player throughout the pet market at discounts of 20% to 30% below retail, and it’s full free shipping, not Amazon Prime or anything like that. We can’t compete with that, so we don’t. We sell what only we can sell and leave them to fight everyone else for what’s available everywhere.”
- Microstores
  - “We’re getting a normal store, and I think one of the small ones. I’m not convinced the small stores are going to be a game changer because they seem to be going in frontiers as well as what PetSmart considers ‘safe’ regions. I don’t know if they can claim new territory for us because they don’t have room to sell a lot of loss leaders or run promotions. It’s all premium, full-price product at that size, more or less. That is what you do when you already have a loyal following for your products, and they know they go to PetSmart to get them. But I guess that’s all part of the experiment.”

## ➤ 10. Regional manager in the Northwest

Sales are increasing slightly based on inflation, but premium food sales are proving somewhat elusive outside of urban areas. Affluent households in the area tend to do their own pet dietary research and then buy specialty products online or from independent service providers. Pet supply stores operate as regional hubs for infrequent visitors to stock up on staples as well as exclusive products. Toys and other impulse purchases are relatively weak. The store’s service mix favors boarding over grooming, giving it a chance to demonstrate its premium food. Neither PetCo nor PetSmart has a natural advantage in the region, but independent retail is hobby-oriented and regional chains are nonexistent.

- Sales Trends
  - “We’re doing OK. Sales are rising a bit as inflation works through our shelves, and we have to charge a few cents more here and there for raw input costs or freight. I’m not sure we’re bringing a lot of people in or getting them in more often.”
- Basket Trends
  - “Natural food is doing well, but it’s off a base of near zero. It’s not the center of what we do. What we do is bulk food, some incidentals, some impulse buys.”
  - “The services are a lot of work and not always all that profitable for us because of the mix. But boarding exposes the parents to our better food. Some of them end up impressed with the difference, so they become regular buyers or mix it in with their bulk buying. We sell more treats and dog vitamins than the actual ultra-natural food. The vitamins from GNC are great sellers, actually.”
- Hard Goods
  - “They still pick up the toys and the sweaters and everything else. But that’s an impulse purchase; how many impulse items do you pick up on the same shopping trip? Impulse buys reward frequency, not so much a store where people come in every three months and spend a few hundred dollars minimum when they do come in.”
- Competition/Online
  - “People who live around here who really want to feed their pets healthy, all-natural food will probably buy cheap cuts of meat from the grocery. Or they’ll shop online and get a break on the price as well as free shipping. Someone who Googles around will figure out what they want and where to find it cheapest. That might be online, or they’ll print out the page and ask their vet to order it for them.”
  - “The footprint is so light across this part of the country that it really depends on which store is closest. You’re looking for a general product category up here and not so much a specific brand exclusive to us or PetCo. There are no other chains up here and very, very few professional independent retailers.”
- Miscellaneous
  - “We favor boarding and training up here, sometimes adoption services. Those are more involved in terms of costs than grooming, which is a straight labor and some equipment sort of deal. Boarding requires a big investment in space and labor and really keeping up an entire facility for the pets, as well as veterinary care on call for emergencies. Training also involves a fair amount of work setting up the classes and again, equipment and labor.”

## 2) PETSMAK STORE MANAGERS

Sales have grown slightly year to year for five of seven sources who commented, are flat for another source and have dropped because of recent price hikes for the remaining source. Two sources did not discuss sales. Three sources said the average basket size is trending up, while four others said it is flat. Food makes up the majority of purchases, and average spending ranges from \$30 to \$100; the higher amounts are driven by premium pet food. Premium pet food is a tremendous growth area for all nine stores. Four sources said at least 50% of their customers buy premium pet food. Hard-goods sales have grown year to year for two sources and have been flat for three sources, including one who said it is the first area in which customers cut back on spending. Three sources said consistent discounting was used to drive traffic; two others said prices are stable but that bags of food have gotten smaller. One source said dog vitamins are a more popular item, while two others said grooming services were a store staple. PetCo is the primary competitor for three sources, while another source said Whole Foods is a growing threat in supplying premium food.

Source	Sales	Basket	Pricing	Product	Premium Food	Hard Goods	Competition
1	Up	Up	Small increase, bag size smaller	Dog vitamins	50/50		PetCo
2	Steady increase	Up slightly	Bag size smaller		Premium <50%, rising	Up	Whole Foods on premium food
3	Store growth				75% is premium, rising	Up 30%	PetCo
4	Food up	Flat, \$30, 3-5 items			Premium gaining	Flat, spending less	Online
5	Still rising	Flat, 3-4 items			Premium >50%, rising		WMT, TGT
6		Up		Services	50/50	Flat	None
7	Down w/ price increase	Flat, \$50-\$70	25% off on 30% of store		Rising		PetCo
8	Flat	Flat \$65-\$100	30% of store discounted		Customers prefer premium	Flat	PetLand
9			Discount to drive traffic	Grooming	Customers prefer premium		

### ➤ 1. PetSmart manager in Kansas City, MO

This PetSmart is getting more competition, especially from grocers, but still has seen business grow because it can provide more selection and advice to customers. Demand for premium pet food has fueled the increase in business.

- Customers
  - “People come in here mainly for food. I’d say 60% to 70% of the sales are food as opposed to hard goods.”
- Sales Trends
  - Our business overall is up, but I don’t know the percentages. Those are not shared with us at each store. But I can see that there is more business and more traffic.”
- Basket Trends

- “The average basket size is increasing a little bit, but I am not sure how much.”
- Pricing
  - “We’ve had small product price increases in the past year, with inflation and the cost of gasoline.”
  - “We have had a lot of negative feedback from customers about the size of the bags of food getting smaller. They are really upset.”
- Products
  - “Another item becoming a bigger seller is dog vitamins.”
- Premium Pet Food
  - “We have seen a steady increase in premium food sales, and now it has about pulled even with sales of the other kinds.”
  - “We are getting more competition from groceries, especially for food sales, but I don’t think it has hurt us overall.”
  - “I push the premium foods pretty hard. I have two huskies, and I know how important it is to their health.”
  - “I try to steer people away from buying at grocery stores, where they might get the standard dog food, Purina or whatever.”
  - “One trend in premium pet food sales is with the Blue Buffalo variety. It has really grown and is very popular. It has ingredients such as blueberries, cranberries and flax seed.”
  - “One food brand, [The Procter & Gamble Co.’s/PG] [Innova](#), has had incredibly weak sales. They don’t do commercials or other advertising, and people are not really aware of it.”
- Competition
  - “PetCo is a competitor in that they have a couple of their own brands that people buy.”
  - “I don’t see online sales of pet foods or products as much competition. People want dog food, they usually go to a store. The can also get personal service.”

We have had a lot of negative feedback from customers about the size of the bags of food getting smaller. They are really upset.

*Store Manager, PetSmart  
Kansas City, MO*

**Reporter Observations:** This PetSmart is on the smaller side but appeared to have a good selection. It is in the middle of a shopping strip that includes a Trader Joe’s and Old Navy. The shopping center caters to wealthy and middle-class consumers. No customers were in the store at 9 a.m. on a Friday.

## ➤ 2. PetSmart manager in a Kansas City, KS, suburb

This PetSmart has seen a steady increase in overall sales, stimulated by stronger consumer interest in premium pet food. However, competition for premium food sales is building from grocery and big-box stores.

- Sales Trends
  - “We’ve seen a steady increase in sales at this PetSmart, consistent with growth across all the stores. I can’t give out the year-over-year growth, but it is up. We look for continued growth this year at about the same rate.”
- Basket Trends
  - “Basket sizes are trending up slightly. It’s probably about half food and half other items on average.”
- Pricing
  - “Prices for pet food haven’t really gone up in the past year, but the size of the bags has decreased so people are paying more.”
- Premium Pet Food
  - “We are selling more of the premium pet food than in the past, and that is growing by a little bit. I am not sure of the percentages. It is getting more popular in both dog food and cat food. People still buy more of the regular food than premium food, though.”
- Hard Goods
  - “People coming into buy premium pet food are also buying more of the hard goods. We’ve redesigned our toy section in that department and added some things.”

We are seeing more competition in the sale of premium pet food, not so much from PetCo as from grocery stores such as Whole Foods and stores like Wal-Mart. Competition from those sources has been the biggest change we’ve seen in the past six to 12 months.

*Store Manager, PetSmart  
Kansas City Suburb, KS*

- “One trend I have noticed is more people humanizing their pets. We are selling more jackets and shirts for dogs, that kind of thing.”
- Competition
  - “We are seeing more competition in the sale of premium pet food, not so much from PetCo as from grocery stores such as Whole Foods and stores like Wal-Mart. Competition from those sources has been the biggest change we’ve seen in the past six to 12 months.”

**Reporter Observations:** This PetSmart was in a strip mall in a middle-class area. It had a dog grooming area in the front windows, as well as a dog daycare. Toys and other non-food items also were located at the front of the store. Aisles were piled high with all varieties of pet food, including organic varieties. A few customers had cartfuls of mostly hard goods during our Friday visit at 2 p.m. Plenty of employees were present, but the manager himself was in the aisle helping out.

### ➤ 3. Manager of a PetSmart in the Chicago area

Natural pet food sales have “exploded” in the last two years. Sales were up 40% to 50% last year and are expected to grow another 20% this year. Low-end food sales dropped 20% last year. Hard goods spending, particularly for clothing, rose recently because of a trend toward small dog breeds. PetCo represents the top competition because of its exclusive brands, including [Natural Balance](#).

- Customers
  - “Customers keep coming back to PetSmart because we are offering them what they want. They like to ask questions and understand what is best for their pet, and we offer them just that.”
- Sales Trends
  - “Our store is one of the busiest in the area. We are still seeing store growth at this location while some other stores are not growing as fast.”
- Premium Pet Food
  - “I have been here six years. Natural dog food sales have exploded in the last year and a half to two years.”
  - “In the upcoming year, I anticipate our natural dog food sales to grow another 20%, maybe even 25%.”
  - “In the last year, natural food sales were up 40% to 45%—maybe even 50%—from the previous year.”
  - “As sales of natural foods are up, sales of the lower-end foods are down in the last year 20% to 25%.”
  - “People are more interested in feeding their pets healthy foods, especially since we are finding out the yucky ingredients they are throwing into the cheap, mass-manufactured pet foods.”
  - “The majority of our customers purchase natural foods versus the lower-end choices. I would say at least 70% to 75%.”
  - “In the last few months, we have added another half of an aisle of natural dog food. Some brands are coming out with additional flavors.”
  - “Blue Buffalo is by far our best-selling natural dog food. There is a Blue Buffalo rep in on the weekends giving out free pet food and promoting the brand.”
- Hard Goods
  - “The last couple of years, the trend in the city is that more people are getting small dogs, and they like to dress them up. In the last year, sales of pet clothing have gone up about 30%.”
  - “In the last three months, people are buying a lot of puppies so everything related to puppies is selling. We have a coupon book that customers are using to get toys, outfits, puppy food and other things.”
- Competition
  - “We consider PetCo to still be our primary competition because they carry certain brands that we do not.”

**In the last few months, we have added another half of an aisle of natural dog food. Some brands are coming out with additional flavors.**

*Store Manager, PetSmart  
Chicago, IL*

**Reporter Observations:** The store had approximately 10 customers in the store on a Tuesday afternoon. Two of the five cash registers were open, and there was no wait time to check out. Customers were spread throughout the aisles, and

several brought their dogs into the store. Most dogs brought into the store were smaller breeds. The staff seemed very friendly, helpful and attentive to customers.

#### ➤ 4. PetSmart manager in a New York city suburb

Customers pick PetSmart over other stores because of its outstanding customer service and large selection. Hard-good sales have been flat as people watch their spending on non-food purchases. Food sales will continue to rise as more people adopt pets and join the trend toward healthier, pricier brands. Premium brands Blue Buffalo and WellPet LLC's [Wellness Core](#) are this store's most popular food. Basket size likely will stay at three to five items per visit. Online retailers pose the biggest threat because of their prices and selection of pet medications and doctor-ordered specialty foods.

- Sales Trends
  - “Our sales will continue to rise for food. More people are getting pets. People are taking better care of their pets and feeding them healthier pet foods that cost a little more.”
- Basket Trends
  - “Our average basket size is three to five items. It's almost always a bag of food or cans of food and then some treats and a toy. People typically spend \$30 per visit. I don't see that changing.”
  - “The average basket size will remain consistent. It's not that people are getting more pets; it's that more people are getting a pet and buying higher-quality food for that pet. That's why you'll see our sales go up, even as basket sizes don't.”
- Premium Pet Foods
  - “Our most popular pet food brands are Blue Buffalo and Core, which are both in that premium category. Blue Buffalo and [Dentley's Rawhide](#) are hot selling treats.”
  - “The typical markup on a four-pound bag of premium food like Blue Buffalo over a nonpremium brand like Purina is \$14 versus \$17.”
  - “Premium foods are definitely inching out the nonpremium foods.”
- Hard Goods
  - “Hard-good sales have been more or less flat year to year, especially for nonnecessities like toys. People are still buying toys, but nowadays they might pick the cheaper one, or pass on buying a second toy. ... If somebody is trying to save money, they'll typically give up toys before treats, and treats before the food they like.”
- Competition
  - “The biggest thing that distinguishes PetSmart from other pet supply retailers is the quality of our service. People rely on us for advice on finding the right product.”
  - “Our biggest competition is online retailers like [PetMed Express Inc.'s/PETS] [1-800-Petmeds.com](#) and [PetCareRx](#). They seem to do a good business with medications that we might not have and with foods for pets with dietary restrictions. They have a large and growing selection, and they can sometimes beat us on price. The reason that's a problem for us is people tend to stick with a favorite food, and if they know they can get it cheaper online, they'll keep going there for it.”

Our average basket size is three to five items. It's almost always a bag of food or cans of food and then some treats and a toy. People typically spend \$30 per visit. I don't see that changing. ... If somebody is trying to save money, they'll typically give up toys before treats, and treats before the food they like.

*Store Manager, PetSmart  
New York City Suburb, NY*

**Reporter Observations:** Three employees, a manager and six customers were present on a Tuesday at noon. The manager twice helped customers find a product and later took a phone call from somebody asking for food suggestions for a sick dog. This store did not appear to offer grooming or any other services. The rear of the store contained an estimated 700 cat food SKUs and at least 800 dog food SKUs; about a third were marked down.

#### ➤ 5. PetSmart manager in a New York city suburb

This store's competition comes from big-box stores like Wal-Mart and Target and, to a lesser extent, from grocery chains. What distinguishes PetSmart is its superior, hands-on customer service. Customers' increasing willingness to spend more for premium pet food is pushing this store's sales higher. Its assortment of hard goods and foods is growing, with premium food brands taking more shelf space from non-premium brands. [Royal Canin](#) (of which Mars Inc. owns 60%) and



Blue Buffalo are this store's top selling food. The average basket size likely will remain at three to four items. Foot traffic was considerable when this store opened two years ago; it has since continued to grow but at a slower rate.

- Sales Trends
  - "Store traffic was huge when we first opened because we're getting so many people who before had to go to a smaller store. Store traffic is still rising today but not as fast as when we started."
- Basket Trends
  - "I would say our average basket size is three or four items. That's remained about the same since we opened, so I guess I can't see it really changing."
- Premium Pet Food
  - "More and more people will pay extra for better pet food, and that's pushing sales up. You'll have to call corporate for the figures, but I can say that things are good and sales are rising year over year."
  - "Since we opened two years ago, our selection of both food and hard goods has grown and grown, especially for the more expensive food items."
  - "The more people are willing to pay extra for food, the more premium food you're going to see on the shelf. It's hard to say what the breakdown is, but it's definitely more people buying premium than non-premium these days."
  - "Our best [food] sellers are Royal Canin and Blue Buffalo. Outside of food, the 'wee-wee' pads and all of the toys are popular."
- Competition
  - "Wal-Mart and Target are big competition for PetSmart. But I still feel we're the best because of our customer service. At the other stores, the staff just points to where the product is. But we take you to the product and then tell you about it."
  - "You can also find pet products at local supermarkets, but they don't come close to us on selection and theirs is more nonpremium brands that people aren't buying as much of."

It's hard to say what the breakdown is, but it's definitely more people buying premium than non-premium these days.

*Store Manager, PetSmart  
New York City Suburb, NY*

**Reporter Observations:** This especially large PetSmart featured an on-site animal hospital, a pet hotel, doggie daycare, an adoption center for cats and a grooming room. The front half of the store had six or seven rows of leashes, collars, toys, beds and cleaning supplies on the left side and live birds, fish, reptiles and small mammals in cages and tanks on the right. The rear half of the store was filled with at least a dozen aisles of cat and dog foods, and at least 200 SKUs in each aisle. About one-third of the food products appeared to be sale-priced. About 20 customers and 10 employees were present on a Tuesday at 6:30 p.m.

## ➤ 6. Manager of a PetSmart in suburban Chicago

The company will continue its growth pattern because of its customer service and knowledgeable staff. Shoppers are spending more in stores but unit growth is not very significant. The source cited no market for midrange pet food and said sales of higher-end and low-end food are even. Blue Buffalo is this store's top selling natural food. Hard-good sales are flat and seasonal. Staff often refer customers to PetSmart's website for its larger selection.

- Customers
  - "Customers shop here because of the variety we sell. We have more of a selection, and our customer service is better. Customers tell me so."
- Basket Trends
  - "Data tell us customers are spending a bit more in the store, which is surprising given online sales. Customer spending is up, but it is not by much."
- Products
  - "Services do well. We just have to keep them well staffed. It is not a problem at the moment to get and keep good staff in services area."
- Premium Pet Food

Sales of higher-end, natural pet food are about even with the traditional foods you can find at a grocery store. ... Hard goods are doing OK. We have not seen any recent surges in their sales at this store.

*Store Manager, PetSmart  
Chicago, IL*

- “Sales of higher-end, natural pet food are about even with the traditional foods you can find at a grocery store.”
- “We don’t really sell the foods that are in the midrange. People either buy the low end or the high end.”
- “Blue Buffalo is hands down our top-selling natural food. Wellness and [Mars Inc.’s] [Nutro](#) do OK, but their sales don’t compare to Blue Buffalo.”
- “In the last few years, natural food sales have definitely taken off.”
- Hard Goods
  - “Hard goods are doing OK. We have not seen any recent surges in their sales at this store.”
- Competition
  - “We don’t have any direct competition at this store as there is not a PetCo or [Pet Supplies Plus](#) very close. But as a company, they are our competitors.”
  - “Customers shop here over our competitors because we offer a better in-store experience. Our customers tell us we have quality and knowledgeable staff and the quality of our services is better.”
- Online
  - “We do not have figures for our online sales, but we are always referring our customers to our website. We may have 20 different vitamins for dogs, but online we probably have at least 50.”

**Reporter Observations:** Foot traffic was slow on a Thursday afternoon, with five to 10 customers present. This location appeared a bit worn and rundown. The training area was small and disassembled, and located in the back of the store. One of the four registers was open. Toys by Martha Stewart were in the main aisle. Staff members were few in number and not very interactive. Customers were buying cat and dog food, hay stuff and cat litter. No dogs were being groomed.

## ➤ 7. Manager of a PetSmart outside of Philadelphia

Customers choose PetSmart because of product selection and fair prices, including discounts on about 30% of items in the store. However, sales have declined in the past two months in part because of recent price hikes on most items. In the next six months this source expects to be challenged to meet sales goals on pet food and hard goods but to exceed to the sales goal for the grooming center. Premium dog food made by the Blue Buffalo is this store’s best seller. The average basket is \$50 to \$70 and is expected to stay in that range or increase slightly because of seasonal flea and tick treatments. This store’s main competition is PetCo; customers often think this store is a PetCo. This store sponsors dog rescues several times per year. Although new owners get the dogs for free, they often spend \$250 to \$500 in the store on food and supplies on pickup day.

- Customers
  - “We have very loyal customers at this store. I think they shop here because of the selection and fair prices. We also generate a lot of business because of our grooming services.”
- Sales Trends
  - “Sales have slowed since we started raising prices about two months ago. It has become harder and harder to meet the weekly sales goals. I think the next few months are going to be about the same in sales from the floor products, but the grooming center should see an increase due to the warm weather and the flea and tick treatments.”
- Basket Trends
  - “The average sale is in the \$50 to \$70 range. A bag of the premium dog food is around that price alone so I expect it to stay in that range for a while.”
- Pricing
  - “We have a 25%-off promotion going on right now on about 1,000 items in the store, but at any given time I would say we are offering discounts on at least 30% of the inventory.”
- Premium Pet Food
  - “There is a trend toward premium pet food because in the long run it saves on vet bills. We have had a long-time partnership with the Blue Buffalo for excellent-quality pet food products, and that is our leading seller by far.”

Sales have slowed since we started raising prices about two months ago. It has become harder and harder to meet the weekly sales goals. I think the next few months are going to be about the same in sales from the floor products, but the grooming center should see an increase due to the warm weather and the flea and tick treatments.

*Store Manager, PetSmart  
Philadelphia, PA*

- Competition
  - “Our biggest competition comes from PetCo; in fact, a lot of customers think they are in a PetCo when they shop here.”
- Online
  - “Online sales have not had much of an impact on us yet. I don’t think we are losing a lot of sales to online companies. We offer price matching.”
- Miscellaneous
  - “One trend that is catching on at least at this store is pet rescue adoptions. We help set it up and have all the paper work arranged ahead of time, and then the new pet owner picks up their pet at no charge at the store. We just did one and had 17 new pet owners in the store spending \$250 to \$500 on food and supplies. It really gives the sales numbers a shot in the arm.”

Reporter Observations: The store had 25%-off sale signage both outside and inside. Traffic initially was light during our Tuesday visit starting at 9:30 a.m., but then four or five more shoppers came in during the next 30 minutes. Grooming services and pet food were the most common purchases. The store was neat and clean.

## ➤ 8. PetSmart sales associate in the Philadelphia area

PetSmart’s pet adoption and rescue efforts along with its liberal return policies are credited for its popularity. Sales have been flat at this location and are expected to increase slightly this spring as owners spend more time outdoors with their pets. Premium pet foods are in demand, with Blue Buffalo and Colgate Palmolive Co.’s (CL) [Science Diet](#) the clear leaders. Average basket sales fell in the \$65 to \$100 range. Discounting and sales are commonplace. The [PetPerks](#) loyalty program is popular.

- Customers
  - “Customers like what PetSmart stands for. We don’t sell puppies or kittens; instead we promote adoptions and rescues.”
  - “We also have a great return policy. If your pet does not like the new food you just bought, bring it back and exchange it.”
- Sales Trends
  - “Sales have been flat for the past few months. I expect it to stay that way or maybe increase slightly with the warmer weather and more people getting outside with their pets.”
- Basket Trends
  - “I would say the average sale is in the \$65 to \$100 range. If you look at the price of the food alone, it’s going to add up in a hurry.”
- Pricing
  - “We always have items on sale. It is around 25% to 35% of the products we carry, and it is always changing.”
  - “We really push the PetPerks card, and our customers use it. They’re alerted to when the items they buy the most go on sale, and they really like that.”
- Premium Pet Food
  - “Our customers prefer the premium brands of food, with Blue Buffalo and Science Diet being the most popular.”
  - “No matter what is going on with the economy, people will spend money to take care of their pets.”
  - “Pet food is the biggest seller for us. Compared to hard goods and other products, I would estimate it’s about 60%.”
- Hard Goods
  - “I have not seen a decline in hard-good sales to support the purchase of the premium brands. Like I said, our sales have been flat so we seem to be maintaining in all of our departments.”
- Competition
  - “[PetLand](#) is our biggest competitor, but we have customers tell us that we run a much better store.”

I would say the average sale is in the \$65 to \$100 range. If you look at the price of the food alone, it’s going to add up in a hurry.

Sales Associate, PetSmart  
Philadelphia, PA

*Reporter Observations:* The store had 25%-off sale signage both outside and inside. Traffic was heavy; 20 to 25 shoppers were present and three checkout lines were open on a Tuesday at 4:30 p.m. Two customers were waiting for the vet, and the grooming center had two dogs being worked on. Flea and tick displays were right inside the door.

## ➤ 9. Store associate at a PetSmart near Los Angeles

Discounting drives this store's traffic. Grooming services have picked up, resulting in other product purchases while customers wait. Blue Buffalo is far and away the most popular dog food. Customers are increasingly opting for premium food, swayed by the healthy ingredients and marketing message.

- Pricing
  - "We've been discounting a lot to get people in the store. When we first opened [within the last year], we held some massive sales, but we try and keep discounted stuff in the store all the time. Some people just won't buy unless it's on sale. We don't really discount food or toys, but we do discount doggy clothing. We also give out gift cards to loyal customers or those that have their pet stay in our pet hotel or get groomed. I think people use the gift cards mostly for toys."
- Product
  - "When we opened, most people were coming in for the usual pet products: supplies, toys and food."
  - "Because our store was new and clean, more and more people started to use our grooming services. People always buy things when they get their pets groomed, and I've been seeing the same pets and pet owners several times now."
  - "I'm always seeing people with cat litter and cat accessories. While we certainly sell a lot of dog toys and food, I just feel like I've been seeing an absurd amount of litter go out the door."
- Premium Pet Food
  - "Without question, our top-selling dog food and treats have to be the Blue products. They sell so well and so fast. People just love them. And it's not even one flavor or type, across the board Blue foods are the favorite. I see mostly Blue Buffalo and its [Blue Freedom](#) the most."
  - "Our customers certainly seem to prefer high-end organic foods. It's almost like the more complex and healthy the dog food sounds, the more likely it will sell."

Without question, our top-selling dog food and treats have to be the Blue products. They sell so well and so fast. People just love them. And it's not even one flavor or type, across the board Blue foods are the favorite. I see mostly Blue Buffalo and its Blue Freedom the most.

*Sales Associate, PetSmart  
Los Angeles, CA*

## 3) EXECUTIVES AT TRADITIONAL OFFLINE COMPETITORS

All four sources who commented on sales said year-to-year growth is in the 10% to 20% range. Five of nine sources said the average basket size has increased around 5%, while two reported a decline. Two sources said the average ticket was around \$35. Four sources, including three posting price hikes this year, said they do not discount and that it has not hurt business. Another reported being priced higher than PetSmart, one is the same and another is below. Pricing is all over the map compared with PetSmart, but only one source reported being priced below Amazon's [Wag.com](#). Pricing pressure does not appear to be an issue. Four sources said premium food makes up 25% to 95% of food sales, with 30% being the average markup for premium. Premium food has become a dominant performer for these sources and has plenty of room for growth. Hard-good sales have declined for two sources but have been steady for two others. Markups for hard goods are at least 50%. Sources do not view PetSmart as their chief competitor nor are they intimidated by the retailer. Two sources even said having a PetSmart nearby helps drive traffic to their stores. These sources have more boutique, high-quality offerings and compete more with local and regional brands. PetSmart's strength is its scale and selection, while its underwhelming staff is its weakness. Only one source said online retailers were a threat to sales.

Source	Sales	Basket	Pricing	Online	Premium Food	Hard goods	PetSmart
1	Doing well, 15% store growth	Up 20%		No presence	50/50		Intrigued by microstores
2	Up 15-20%	Up 5%	Not discounting	Not an issue, price match	Lots of room for growth		PETM not hurting them
3	Up 10-20%	Down	Prices up 5-10%		Lots of room for growth		Loyal customers not going to PETM
4	Up	Up yy, \$36 avg	No discount but promotion	Testing online	95% is premium, 30% markup	Fewer toys, 55-70% markup	PETM scale but weak staff
5		Up slightly		No presence	25-30% markup		PETM drives traffic
6		Down 5%	Above PETM, match independents		25% is premium, 30-35% markup	Down	Well positioned, weak staff
7		Flat, mid-\$30	Food price increase up 3-10%, bags smaller	No presence	80-90% is premium	Flat, not necessity	Wide selection, poor staff
8		Want U.S. made	Same as PETM, higher than Wag	No presence		Flat, 50% margin	Local threat more than PETM
9		Up with prices	Lower than PETM and Wag		Largest growth		PETM low end not premium

➤ **1. President for a national pet retailer with more than 100 stores**

The pet business remains robust as new products, better food and exotic animals become more mainstream. PetSmart and PetCo now play a primarily reactive role in the industry. National chains may have hit a scale barrier, giving regional operators an opportunity to take share. The relative absence of M&A indicates that national chains have stopped growing at an appreciable rate.

- Sales Trends
  - “We are doing well. The South and Southwest are new territories for us, so we’re taking our time and not rushing in to challenge anyone larger than ourselves on their home ground. But we are looking forward to further expansion.”
  - “Last year our store count went up by about 15% and that was felt throughout our same-store sales, all the metrics.”
- Basket Trends
  - “Transactions are up about 20% on each basket from where it was last year. Most of that is upgrading the food from grocery brands or what someone could get at PetCo. When someone comes in for the first time, we bring them up to our baseline basket fairly quickly, which is a premium blend, vitamins and the occasional toy.”
- Premium Pet Food
  - “I don’t know what you’re defining as ‘premium’ food, but we probably have a 50/50 mix at this point between things you

**We probably have a 50/50 mix at this point between things you can get at the grocery and things you need to come into a specialty store to buy. Premium is becoming dominant.**

*President, National Pet Retailer  
With Over 100 Stores*

can get at the grocery and things you need to come into a specialty store to buy. Premium is becoming dominant.”

- “The grocery brands are there as promotional items, really. Pricing on them is declining, but we sell as little of it as possible except as an advertised sale item. Mostly we have it in the stores as a visual aid for the assistant to say, ‘Oh, but we have something better over here,’ and move the conversation toward an enriched formula down the aisle.”
  - Competition/PetSmart
    - “PetSmart’s new stores are especially interesting because these are by definition post-PetCo or post-PetSmart stores. They’re a third-party alternative coming into a region that’s already familiar with the big-box pet chain world and maybe a little tired of having two flavors of big-box and nothing else to pick from. These managers are picking business away from those competitors every single day. They’re the new world of pet retail. I think that tells you where I see the wind blowing right there.”
    - “PetSmart and PetCo are too big. I think it makes it hard for them to do some things.”
    - “PetSmart and PetCo may claim to be moving up market with premium food and more loving relationships to the animals, but their underlying business is still big-box volume. I think that’s a dangerous place to be in if they still think they want to innovate.”
    - “It takes a lot of food to keep a gigantic 1,100-store animal running. If you do it organically, you need to be building the equivalent of at least 30 to 50 stores a year just to grow alongside the overall economy, maybe 2%. That’s really a minimum. Otherwise, your stores are aging, your market may be stagnating or slipping away from you, you are not gaining share. If you do it through M&A, you need to be buying at least a 30- to 50-store chain every year just to keep up.”
  - Online
    - “The big chains are the ones hurting over online pet food sales. A decade ago, online pet food was the big, transformative force that was going to kill all the local pet shops. It turns out the model was a bust, and it left a huge bad taste in the executives’ mouths. Now they see pressure from Amazon or whoever on their bulk products, so it scares them. They discount the bulk products aggressively to match the online prices, maybe 20% to 30% off. They try to move up and get away from the bulk world, but that’s where we already are.”
    - “We are not a bulk seller. We are not an e-commerce company. They compete with each other, not so much with us. That’s how we survive.”
- **2. CEO for a regional pet retailer with more than 100 stores**

Pet retail is a robust business with plenty of room for upstarts to expand. PetSmart and PetCo are the only two national competitors in this region, and neither is differentiating itself as a value-added vendor. Store design and product choice play crucial roles in both building long-term customer relationships and upselling toys and accessories. The persistence of independent pet boutiques ultimately may work against the national chains.

- Sales Trends
  - “Business is booming. We have been tracking 15% to 20% growth every year since 2009, and our store numbers are trending at roughly those levels. Floor traffic is up maybe 20% to 25% across the chain, but obviously a lot of that is new stores with no comparisons to offer.”
  - “We are getting a lot of new customers fleeing the big-boxes.”
- Basket Trends
  - “Our average transaction is maybe 5% bigger. Basket is growing a little above traffic as we deepen existing relationships and upsell increasingly healthy food and more fun accessories. Our model is proving itself, and we are generating enough cash to accelerate our expansion.”
- Pricing
  - “We are not aggressively discounting, and it doesn’t seem to have hurt us one bit.”
- Premium Pet Food

**Business is booming. We have been tracking 15% to 20% growth every year since 2009, and our store numbers are trending at roughly those levels. ... Our average transaction is maybe 5% bigger. Basket is growing a little above traffic as we deepen existing relationships and upsell increasingly healthy food and more fun accessories.**

*CEO, Regional Pet Retailer  
With Over 100 Stores*

- “PetSmart’s house brands of food represent a huge leap in terms of pricing for them because it’s maybe \$1, \$1.20 a pound if they really trade up. That’s a premium product for them. It’s an extra 70¢ a pound on one bag per month. All of our food starts at the \$1.20 a pound level, so I guess it’s all ‘premium’ for us. Once you’re here, ‘premium’ only grows until you’re looking at \$3 to \$4 a pound for special occasions.”
- “A pet owner relationship means maybe a bag of food a month at 50¢ a pound retail. That’s a commodity item in the grocery cart, like toilet paper or shampoo. But pet owners have a lot more love for their animals than that 50¢ a pound represents.”
- Competition/PetSmart
  - “PetSmart and PetCo are in our region but don’t seem to be hurting us. We’re growing a lot faster here than they are.”
  - “We’re still adding 15 to 20 stores a year across our multistate territory.”
  - “The problem I see with the national chains is they’re too involved in growing with the category. They’re not so much interested in growing the average basket or the depth of relationships or monetizing the pet relationships that already exist.”
  - “If I was in the national chains’ shoes, I’d worry about the continued existence of independent pet stores as well as the regional chains.”
  - “We have our eyes on the independents and they don’t actually view us as a threat. They hate PetSmart in particular. The salons and kennels compete directly with the independent vendors.”
- Online
  - “Online is not an issue for us. We don’t match prices, and we don’t sell what mass-market chains sell. I am seeing both the online and offline mass-market food sellers offering a lot of price breaks as they fight each other for their end of the market.”
- Strategy
  - “Our approach is to get the ‘other’ pet products in front of our people as keys to unlocking that commodity food relationship. Our stores are set up with the food in the back and the toys, sweaters and bowls and posters between the door and the food.”
  - “Ultimately, you want to build long-term relationships so you can rely on that bag of food moving from your shelf to that bowl every month. Then you can sell up, feed in services, whatever you want to do. But in a commodity business, the more of those bags of food you can capture—in the sense of captive customers, people who come in month after month—the closer you are to winning.”
  - “We do that by aiming a little upscale, a little aspirational, a little fun. We get a lot of single, professional women, no kids. These are their children.”

### ➤ 3. CEO for a regional pet retailer with 25 stores

Although premium pet food is emerging as a national craze, claims made for some brands are difficult to back up and will not help vendors attract or retain long-term customers. Growing awareness of pet nutrition works in smaller chains’ favor. Established premium food channels predate the rise of big-box chains, and their retail relationships never suffered. PetSmart and PetCo are competitors only to the extent that they fill bowls that might otherwise contain true, all-organic food.

- Sales Trends
  - “Buzz around pet food quality is helping us. We are getting a lot of new people, maybe an extra 10% to 20% of our business. Not all buy, but they look around and we’ve built awareness.”
- Basket Trends
  - “Those who do buy tend to start small, so our average cart is actually smaller as we educate them. But next year they’ll be up to speed, and we’ll have them where they need to be.”
- Pricing
  - “We are able to raise our prices with the market, so even if our customer base was flat, we would still be showing an extra 5% to 10% increase over last year.”

**We are able to raise our prices with the market, so even if our customer base was flat, we would still be showing an extra 5% to 10% increase over last year. ... We only sell what they would consider ultra-premium food. No bulk products, no toys.**

*CEO, Regional Pet Retailer  
With 25 Stores*

- “After a certain point—about \$30 per 15-pound bag of food—you are not increasing your margins anymore.”
- “We do not discount.”
- “Our input costs are not cheap but our customers know it, so we can pass along inflation plus our additional expenses. We are not absorbing costs or downgrading our supply chain to protect our margins. When beef prices went crazy, butchers raised their prices and we raised ours. As a result, I see where someone like PetSmart is barely growing at the food inflation rate.”
- Premium Pet Food
  - “We only sell what they would consider ultra-premium food. No bulk products, no toys.”
  - “There’s still a lot of room for improvement before the PetCo or Wal-Mart or Target ‘premium’ brands really live up to what veterinarians will feed their own animals. Until they do, truly health-conscious buyers will gravitate toward the truly premium food and just won’t stick around for anything less.”
- Competition/PetSmart
  - “We’ve grown very slowly by big chain standards, maybe one store a year in total. Meanwhile, PetSmart and PetCo were growing and evolving to build the largest number of stores to serve the largest number of people. Our customers never migrated in the first place. They’re more loyal than ever.”
  - “I would not consider the big chains as competitors because our customers don’t consider them alternatives. PetSmart says they have private-label brands that are exclusive and wonderful, which is nice until you see that it all comes out of the same processing facility that feeds every other pet store in the country. We truly are the biggest vendor of just about everything we sell.”

#### ➤ 4. Founder and president of a national pet supply chain with 30 stores

PetSmart has the money, the scale and the model to emulate and admire. However, other national chains also are doing well. This source’s company sells 95% premium food but has started offering less expensive foods in some locales to appeal to the neighborhood demographic. So far this seems to be working as customer count, sales and profit margins are up. Overall, customers are looking for value.

- Sales Trends
  - “Our customer count has increased for same-store sales. Our visits and our transactions are up, along with our average sale and our profit margins.”
  - “We are very competitive on price. Our sales and customer numbers are up.”
- Basket Trends
  - “Average basket sizes are up a little bit compared to 2011. In 2012 our average ticket was \$36, which seems low considering how high pet food is. We have people who buy crickets for \$1. Top-selling items are pet food and other consumables—cat litter, stain and odor products.”
- Pricing
  - “There have been significant pricing changes—more in the flea-control area. [Merial](#) and [Bayer](#) [[AG/ETR:BAYN](#)] feel completely OK to charge a 7% or higher increase, so they price themselves in the \$50-plus mark. [[FidoPharm.com](#)’s] [PetArmor](#), which we will stock this year, is half the price.”
  - “No products are being discounted. That is different from being promoted. Like food—you take less of a margin on it. We are not discounting Science Diet; we are promoting it strategically at a certain price.”
- Premium Pet Food
  - “The dog food department is the strongest performer.”
  - “Our sales are 95%-plus premium pet food, mostly because a lot of our stores are in those premium areas. But we do have a few stores in the middle of nowhere, and the economic profile is less disposable income.”
  - “With premium food, you have a 30% markup after discounts. And that is a diluted average.”
- Hard Goods
  - “Hard goods has a 55% to 70% markup—for toys, chews, collars, shampoos.”
  - “People are buying fewer toys, maybe fewer treats.”
- Competition/PetSmart

Hard goods has a 55% to 70% markup—for toys, chews, collars, shampoos.

Founder & President  
National Pet Supply Chain with 30  
Stores



- “Scale is PetSmart’s strength, and its weakness is still probably people. Their wellness plan and the veterinary is great, but other than that it is just location. They are clean, they are stocked.”
- Online
  - “We are beta-testing our online. We realize the critical importance of being there, but I do not think it is going to make us rich by any means.”
  - “Regarding online and offline pricing pressures, I do not hear about it. They are not really saying, ‘Hey, this is PetSmart’s price; will you match it?’”

## ➤ 5. President of a national pet supply retail chain with 20 stores

PetSmart’s reputation is shoddy at best, and the chain is considered the Wal-Mart for pets. Once a premium pet food enters PetSmart, the quality inevitably plummets, and then many independent stores and chains drop the brand. Nearby PetSmart stores have helped draw in customers to this chain. PetSmart has brand recognition and buying clout, but most of its purchasing benefits are mitigated by its huge overhead. The source’s basket average is up slightly.

- Basket Trends
  - “Average basket size, if anything, is trending up a bit, but I have not seen anything drastic.”
- Premium Pet Food
  - “This industry is centered around mutual trust and support, and when a brand chooses to go into a big-box store, independents don’t want to work with a company that does that type of thing.”
  - “Innova, Evo and California Natural are part of the same family. Several years back the owners sold to Procter & Gamble, and the writing was on the wall that they would inevitably go into big-box stores. When they go into a PetSmart or PetCo, fear goes in and the only thing independent retailers can do is choose not to carry that food anymore.”
  - “First, they get into the big-box stores, and almost invariably within six to 12 months of doing that they start switching up the quality of the product.”
  - “Our business is focused on more natural and holistic-type products, and we have seen strong growth in our particular niche.”
  - “The industry’s biggest performer is Blue Buffalo. Natural Balance used to be but is losing some of its ground.”
  - “Nationally recognized brands, which include [P&G’s] [Eukanuba](#), Royal Canin, Natural Balance and half a dozen others, will sit about 25% markup on the big bags, 27% on the medium bags and 31% on small bags.”
- Competition/PetSmart
  - “PetSmart is on the edge of Wal-Mart for pets, in terms of quality and approach.”
  - “Whenever there has been a big-box retailer in the vicinity of one of our stores, it has actually increased traffic flow to our stores. We have never really felt threatened by PetSmart and have only had a benefit because of their presence.”
  - “PetCo started opening up a line of stores called [PetCo Unleashed](#), which offers more of a friendly shopping experience. PetSmart is missing the boat on this.”
  - “PetSmart has strength in brand recognition and purchasing clout. But most of those purchasing benefits are mitigated and lost because of the overhead and costs they have to maintain.”
- Online
  - “We do not do any online, primarily because we are also a franchise system with independent owners, and if we do an online offering we are competing with our own franchisee. It is within our realm to do it, and we may choose to do it somehow.”

“Whenever there has been a big-box retailer in the vicinity of one of our stores, it has actually increased traffic flow to our stores. We have never really felt threatened by PetSmart and have only had a benefit because of their presence.”

*President  
Natl. Pet Supply Retail Chain with 20  
Stores*

## ➤ 6. Executive vice president and COO at an East Coast retailer with five stores

With big-box stores like PetSmart ramping up their natural and organic brand offerings, this source's company has lost its point of differentiation. Her company also has felt the pinch from Internet stores and other big-box retailers. PetSmart is well positioned to take advantage of the natural/organic explosion while also offering services like dog daycare, veterinary care and dog training. But PetSmart has flaws: Its customer service is terrible and employees lack knowledge about premium foods. Its stores also exude a impersonal warehouse feel.

- **Basket Trends**
  - "Our basket size for first quarter this year versus last year is actually down, by maybe 5%. We had been trending up significantly, 10% to 12%."
- **Pricing**
  - "We competitively shop our key brands on a six-week rotation. And we shop the closest big-box stores, independents, PetValu and Pet Supplies Plus, so we look at that pricing. I am slightly above PetSmart, always below PetCo, and I match the independents. I do not shop at Wag.com so I do not know [about their pricing]."
- **Premium Pet Food**
  - "Today, we are at 125 natural and organic brands. We saw this as a real opportunity to enter the marketplace in a boutique format—6,000 to 8,000 square feet, and focus on natural organic."
  - "Organic brands require staff education to sell them to the customer. Today the customer is much more educated."
  - "It is very likely that pet food manufacturers will enter mass retailers over the next year. That is the way they are going to grow their businesses."
  - "Food is nearly 60% of our total sales."
  - "Natural organic food, dog food primarily, has been our strongest performer in our stores this year. Up until the first quarter, it would have been treats and toys."
  - "Premium food is about 25% of our sales. So from my perspective, those premium brands that I would define as natural organic and holistic have about a 30% to 35% markup. Margins are higher for products that are not in the big-brand food categories. We carry 93 brands of pet food."
  - "Our customer has not traded down on the food. Food sales have continued to show very strong growth. We do carry [P&G's] [lams](#), but that would be the only quasi-grocery food we carry."
  - "We will continue to expand our premium pet food offerings because it is important, as these foods move into big-box, that we continue to develop our own independent house brand."
  - "There are many independent retailers who will drop a brand if it goes into the big-box stores."
- **Hard Goods**
  - "Hard goods are down, and we are wondering if that is a function of the economy."
  - "People are not spending as much on the discretionary items."
- **Competition/PetSmart**
  - "PetSmart is well positioned and very smart because they offer various services—boarding, training, [Mars'] [Banfield](#) pet hospitals. For the average pet owner, there is real value there."
  - "PetSmart's customer service is terrible and their product knowledge is poor. It is a cold warehouse-like experience."
  - "Some pet parents are so educated [about their pets] that it does not matter if PetSmart's staff is not knowledgeable."
  - "Big-box retailers are our strongest competitors. They are household names."
- **Online**
  - "Now the large growth rate is coming from Internet stores."
  - "There is a greater focus now on online sales, but not for our company at this time. We do not have the resources—time, money, people. People are willing to spend 20% to 30% more per bag to have it on their doorstep. With the explosion of other sites, such as Wag.com, Amazon, it has become very price-

Premium food is about 25% of our sales. So from my perspective, those premium brands that I would define as natural organic and holistic have about a 30% to 35% markup. Margins are higher for products that are not in the big-brand food categories.

*Executive VP & COO, Retailer  
Five Stores, East Coast*

competitive and the customer is willing because they are not overpaying for the convenience. It is the retailer who is suffering.”

## ➤ 7. Marketing manager for a Midwest retailer with five stores

Big-box retailers are not much of a threat to this source’s company. PetSmart’s strength is in its size and its ability to offer a variety of products and services, but its sales staff are not readily available or knowledgeable. Also, PetSmart does not offer the same high-quality brands as in independent stores. Roughly 90% of the pet food sold at this source’s chain of stores is considered premium, and business is good. Today’s pet owners are gravitating toward higher-end foods. Pet food manufacturers launched price hikes of 3% to 10% earlier in the year, but the average basket remains in the \$35 range. She expects very few premium pet food makers to enter the mass market this year.

- **Basket Trends**
  - “Our basket size really varies from store to store. Each of our stores draws a slightly different clientele. Some cater to some blue-collar customers, some cater to white-collar workers. Our average transaction per customer is in the mid-\$30s.”
- **Pricing**
  - “Around the first of the year most of the pet-food companies had price increases, and if they do not take a price increase, they decrease the size of their bags. Customers do notice. Price increases are usually between 3% and 10%.”
- **Premium Pet Food**
  - “People tend to be shifting more toward the higher-quality foods. A lot more people are becoming aware of what is in their pets’ food and treats and are going more toward natural, organic, frozen. We have seen an uptick of the higher-end foods and treats because of the recent recall issues.”
  - “At least 80% to 90% of our food is premium.”
  - “Our big pushers in all of our stores are our house brand.”
  - “We carry organic foods, holistic foods, grain-free foods, things that customers will not get at the grocery store and even at some of the mass retailers.”
  - “We carry lams, Science Diet, Nutro, [Nestlé’s] [Pro Plan](#), [Beneful](#), [Fancy Feast](#) to draw in those customers, but we also carry [KLN Family Brands’] [Natural Planet Organics](#), [Nutrisource](#), Natural Balance and other smaller companies that you cannot get in grocery stores. We cater to a wide demographic. We even carry five different lines of raw frozen dog and cat food.”
- **Hard Goods**
  - “Most people shop at our stores for the dog and cat food, and the extras. Some people will pick up the rawhide treats, toys. Other people are barely getting by.”
  - “Hard goods are holding their own. We have noticed in the last six to eight months that they are starting to come back. But once again it will depend on how much disposable income that household has.”
- **Competition/PetSmart**
  - “PetSmart is probably our strongest competitor, and then smaller retailers. But none represent a huge competition to us.”
  - “With PetSmart, it is kind of like having a Wal-Mart nearby and of course, you will draw in certain people. And they have a vet and do offer some services. But we tend to think people shop with us more because of our knowledgeable staff, and because we try to do things to really give back to the community. And we make sure we are not that big-box feel.”
  - “PetSmart’s strength is its size and its ability to offer a nice selection of things.”
  - “PetSmart’s staff is not always the most knowledgeable if you have questions—and if you can find a staff member to help you.”
  - “I would go to PetSmart before I would go to a grocery store. PetSmart is probably doing a good business in our community. Our company has been around and in the community even longer, and we are still doing good business.”

“Around the first of the year most of the pet-food companies had price increases, and if they do not take a price increase, they decrease the size of their bags. Customers do notice. Price increases are usually between 3% and 10%.”

*Marketing Manager, Retailer  
Five Stores, Midwest*

- “A lot of times there is not going to be a huge difference between us and PetSmart, but there will be a huge difference between us and a grocery store.”
- Online
  - “We do not at this point do any online sales.”

## ➤ 8. Manager at a West Coast retailer with two stores

Customer service is helping this company take customers from PetSmart, which offers similar prices but less favorable service. PetSmart is not a threat in the same way as other locally owned pet supply retailers. In general, customers buy a bag of food and a bag of treats. Some purchase hard goods, which continue to do well in these stores. More consumers are asking for the “Made in USA” products. Natural Balance is the store’s best-selling brand. This smaller retailer does not see the need for an online-ordering component.

- Basket Trends
  - “Our average basket consists of a bag of food and a bag of treats. Our customers are always excited to see new items on the shelf, and hearing what the new items are all about.”
  - “The biggest trend we have seen is people asking for USA-made toys and treats. This has always been there, but we have been seeing it more and more due to the ‘made in China’ controversy.”
  - “We have also seen a lot more interest in raw food.”
- Pricing
  - “Our prices are pretty competitive, like everyone else. We are around the same in our pricing with other local pet stores.”
  - “Our pricing is probably around the same as PetSmart and a little high compared to Wag.com.”
- Product
  - “We are always looking for interesting, fun and new products to bring in, which means we consistently bring in and move out product.”
  - “We carry what our customers want us to have. We do not like seeing our food get old on the shelf. If that is the case, we phase it out and bring in what is selling, or what the customers are asking for.”
- Premium Pet Food
  - “At our stores, Natural Balance does the best with both dogs and cats. Natural Balance has an awesome ‘Limited Ingredient Diet’ food.”
  - “Overall in the pet industry, nonpremium pet food has a lead in the market.”
  - “The average on pet food is 30% gross profit margin.”
- Hard Goods
  - “Hard goods are 50% gross profit margin.”
  - “We are not seeing any decline in hard goods. Our customers see their four-legged pet as a family member.”
- Competition/PetSmart
  - “Our competition is probably the other local, individually owned pet stores. Many customers that are typically PetSmart customers go to our store once and keep coming back to us.”
  - “We do not really see PetSmart as huge competition. Our staff is awesome, very knowledgeable and friendly. Our focus is to please our customers and be able to answer any questions, something PetSmart’s employees cannot always do. We provide our employees with informative seminars, and we teach them how nutrition plays a big role in our pets’ overall health.”
  - “PetSmart does not form that one-to-one relationship with their customers. Their strength is probably their shelf space. They are able to offer a bigger selection.”
- Online
  - “There is not at all a focus on being able to sell and deliver products online. We are lucky to have loyal customers who enjoy coming in our store and getting their products from us. Plus, we do not give a shipping fee or make you wait for your products.”

The average on pet food is 30% gross profit margin. ... Hard goods are 50% gross profit margin.

*Manager, Retailer  
Two Stores, West Coast*

➤ **9. Owner of a mid-Atlantic boutique pet retailer with two stores**

PetSmart is weak in the super-premium market and caters more to the low end of the market. This source's business reportedly has no competition. Customers are spending more; prices and per-day sales are on the rise. Most shoppers buy dog food, and premium foods have had the largest growth. His stores' prices are lower than PetSmart and Wag.com.

- **Basket Trends**
  - "The average receipt size is increasing at our stores, and per-day sales are increasing because prices have gone up."
  - "There is not a shift in the types of products people are buying or in the number of products people are buying."
- **Pricing**
  - "Our prices are lower than PetSmart and Wag.com"
  - "All pet categories have increased in price, with foods increasing the fastest."
- **Premium Pet Food**
  - "It is very likely that premium pet food manufacturers will sell through mass channels in the next 12 to 18 months."
  - "Dog food was the strongest performer in our store this year, because most pet owners are dog owners. Premium foods have had the largest growth."
- **Competition/PetSmart**
  - "PetSmart's business is thriving, but they cannot compete in the super-premium market."
  - "PetSmart aims for the low end of the market. They are not a competitor to us."
  - "PetSmart's online offering is similar to others."
  - "Independent chains, specialty stores, mass-market stores and supermarkets are all different business models, and they cater to different customers."

**PetSmart's business is thriving, but they cannot compete in the super-premium market.**

*Owner, Boutique Pet Retailer  
Two Stores, Mid-Atlantic*

#### 4) EXECUTIVES AT NONTRADITIONAL OFFLINE COMPETITORS

These four sources represent a commanding share of the pet supply business. However, none considers it part of their core product, nor do they have any intent of making it so. Still, they did acknowledge greater consumer demand for premium pet food; one source now carries more premium products but on the lower end of the scale. Pet sales represent from 2% to 5% of total sales for two sources, and are growing 5% for one and in the double digits for another. Two sources said the pet category falls under the grocery department, which makes it more complex to even delineate information. No source considers PetSmart or other pet supply chains as competition.

Source	Pet Supply Core	Pet Supply as % of Sales	Pet Supply Sales YY	Demand for Premium Food	SKUs	Compete with PETM
1	No			Awareness spreading	Only food	No
2	No		Up 5%		800; 250 are food	No
3	No	2%-5%	Double-digit growth	Carrying more premium food	30 non-food	No
4	No	3%		Increasing		No

➤ **1. Merchandising executive with an upscale grocery chain**

Premium pet food always has been part of the luxury grocery proposition but will never become a primary focus. Pet food and supplements represent a minimal portion of overall dollar and unit sales. This chain's shoppers are not pet-oriented but to add pet food to their purchases. Accessories and other pet supplies are not a factor.

- Premium Pet Food

- “We have always sold a few brands of high-quality dog and cat food to ensure that every member of the household can get a nutritious meal from the ingredients on our shelves.”
- “But ultimately, people know that we really just sell food. If they want to go to our butcher counter and get something fresh and all-natural for the dog or cat, they can.”
- “In terms of our ‘pet food for pets’ aisle, we have a 2% to 3% share of the pet food market, and I would suspect it’s actually lower. We are not a big player in the premium food for pets space.”
- “Of course, awareness that pets need to eat more natural food too is spreading. The product recalls a few months ago from horse meat in the dog chow really shocked some of our most loyal customers to the fact that pet food is actually food and can be more or less healthy. But this is a small base for us, and we’re not pushing it. We don’t want to be known as the premium pet food company. We want to be known as the premium food company.”
- “People who come in aren’t looking for pet food. They’re buying for their refrigerator, see the pet aisle and say, ‘Why not?’”
- “We just sell food. No collars, no beds, no toys. We don’t do grooming. We have no plans to start.”

In terms of our ‘pet food for pets’ aisle, we have a 2% to 3% share of the pet food market, and I would suspect it’s actually lower. We are not a big player in the premium food for pets space.

*Merchandising Executive  
Upscale Grocery Chain*

## ➤ 2. Category manager for a big-box chain

Structural obstacles probably will keep pet supply on the periphery of this top-tier retailer’s business. The drive to sell brand exclusives has created an environment in which “premium” claims are made for all pet food not explicitly marketed as a value product. These claims are increasingly hard to back up, forcing expensive recalls and PR damage to the category. Overall pet care sales are up around 5% year to year.

- Product
  - “We are probably one of the top 10 biggest pet food merchants in the world, but you would not know it to see our stores or the organization chart.”
  - “Our pet department is under grocery, which makes it tricky to either do the buying for other types of pet merchandise or account for how that business is stacking up for us against a differently integrated retailer like a PetSmart or a PetCo.”
  - “As long as the pet aisle and I are where we are inside the organization, there won’t be a unified push to promote ourselves as a major player in the pet market.”
  - “Our pet business is a small minority of our business and is actually dominated by the accessories in terms of profitability.”
  - “We have about 5% to 10% of the global pet retail market, and it’s still such a small part of our overall business that it’s not a focus area for me much less the company. It’s maybe 800 SKUs, and 250 of those are food. I’d say we’re up 5% over last year, which is about par with the rest of the company.”
- Premium Pet Food
  - “Pet food is more robust because it’s a consumable recurring buy, but we can’t get the same margins because we’re working with a less ‘premium’ product mix. I can’t really focus on bringing in designers on the accessories side or perishable food on the food side. I have bulk dry food and fun but not must-have accessories.”
  - “As for ‘premium’ food, our premium brands generally price at around \$18 for a 15-pound bag, give or take. That’s been rising, but I am also aware that it’s still low compared to where a lot of people selling ‘ultra-premium’ food start. That’s by design.”
  - “We want to create things that were better quality than bargain-basement chow but still priced to attract people who come into the stores.”

As long as the pet aisle and I are where we are inside the organization, there won’t be a unified push to promote ourselves as a major player in the pet market.

*Category Manager, Big-box Chain*

- “In general, ‘premium’ is more marketing term of art than anything else for some people. The more retailers and manufacturers are motivated to create unique products for niche markets—private label, exclusive, proprietary, whatever it might be—the more you get a kind of inflation of claims.”
- “There are a lot more pet food recalls now because the claims have become inflated faster than the actual product has improved. You can imagine what it takes to issue a pet food recall. It isn’t pretty, and even after you pull the ‘premium’ products off the market, you’re impairing the overall shift toward value-added claims and getting people to pay more for a better product.”

### ➤ 3. Category manager for a national grocery chain

Most retailers are embracing “premium” pet food as a way to reinvigorate the entire category and shunt cost pressures elsewhere in their product line. As such, pet food is growing quickly as a component of the chain’s overall sales, even though it remains a very small component of the business. The price spread between premium brands is still so large that very little true competition exists between the grocery and specialty channels.

- Customers
  - “We do not get dedicated pet shoppers coming in. We’re a grocery. We don’t sell more than maybe 30 SKUs outside pet food in the pet category: OTC medications, some accessories, a few toys. Dedicated pet shoppers go to a store with ‘pet’ in the name.”
- Pricing
  - “There’s a lot of room between our premium brands and the specialized ‘pet’ retail brands. Our premium brand pick up at about \$12 for a 15-pound bag, which is still about 20% above our bulk dry formula but nowhere near the \$25 to \$40 that bag might cost at the high end in the pet stores. These brands are not competing. People aren’t debating which one to buy every month. They know roughly where they want to be and they’re already making their choices within their current tier.”
- Premium Pet Food
  - “Pretty much everyone has a premium shelf in the pet aisle. We now sell truly fresh refrigerator-only dog and cat food in the cold foods section as well as your usual wet and dry canned and bagged formulas. Everyone is looking for ways to move that piece of the cart up market a bit without simply pushing prices on the same old products upward.”
  - “Raising prices on a product the shopper has been buying for years doesn’t exactly engender loyalty. It alters the relationship in a way they can notice immediately, and it gives them an excuse to shop around. Instead of protecting your margins on that product, you might have lost that sale entirely to a competitor. Nobody wants that. So the goal is to get the shopper to trade up into a higher price point.”
  - “Pet food is a place where we can do that because it’s a relatively low price point to begin with and a relatively small part of the basket. It’s maybe 2% of our total sales, and among pet owners it’s maybe as much as 5% or 6% of a family’s grocery bill. Cut two steaks a month from the budget and you can double your pet food spend. And pet food has lagged the general health food, organic food, natural food movement, so there’s a motivation for trading up. Suddenly, that 2% of our business opens up and we can pass on some of the inflation we’re absorbing in other categories.”
  - “Double the pet food spend and it’s maybe \$15 per pet per month. That’s not quite our goal here and now, but we are seeing pet food dollar sales up double digits over last year compared to flat to minimal growth all in all. There’s a lot of room to push that needle in the right direction still.”
- PetSmart
  - “Until the gap between our pricing and theirs narrows, there’s no serious competition between us. Maybe people will jump straight from our low-end brands to their higher-end brands, but I don’t think so. They already know there’s a thing called a pet store. It means making an extra trip every month to a new store that doesn’t sell human food.”

**We are seeing pet food dollar sales up double digits over last year compared to flat to minimal growth all in all. There’s a lot of room to push that needle in the right direction still.**

*Category Manager, Natl. Grocery Chain*

## ➤ 4. Pet merchandising executive for a big-box chain

Although a single big-box retail chain sells more pet food across more locations than PetSmart and PetCo combined, the category remains awkwardly positioned between housewares and grocery. Customer awareness and spending on upscale pet supplies are increasing. Big-box merchandising strategy is evolving to offer more premium products at a price point below the specialty chains.

- Customers
  - “We don’t exactly get ‘dedicated pet shoppers.’ We get shoppers who come in for dog food or whatever it might be, but we also get shoppers who come in for some completely unrelated item and also buy dog food. Everyone is a potential shopper.”
- Premium Pet Food
  - “There are a few broadline retailers who sell more pounds of dog and cat food in a year than PetSmart and PetCo put together. We are one of them. This is not to belittle their achievement, their vision or their operations, which I think are great. It’s only to create some perspective.”
  - “We have what I would estimate is a 25% share of the overall pet food market. That’s by dollar spend; if you wanted to look at customer base we would probably score a bit higher simply because of the greater presence of value brands on our shelves. Other pet supply is quite a bit lower but is still a lot of sales across all our stores. But add it up and pet is maybe 3% of our global business.”
  - “The core business for PetSmart and PetCo is a very important but small piece of our business.”
  - “For us, the pet category is tricky to position because people are used to seeing pet food within the grocery environment. We used to split that off from the accessories, so we lost the cross-selling opportunity there. Now we have the pet centers within the stores to combine all that stuff, sort of an in-store specialty pet shop. It’s done great for us.”
  - “People are definitely asking us for more premium pet food brands, and we are happy to give them what they want and raise our average pet cart. Some context might help: our dry bulk dog food starts at around 50¢ a pound, so our ‘ultra’ in-house formulas come in at around \$1.10 a pound more or less. That’s still a lot cheaper than what the specialty chains will charge for roughly the same nutrition.”

People are definitely asking us for more premium pet food brands, and we are happy to give them what they want and raise our average pet cart.

*Pet Merchandising Executive  
Big-box Chain*

## 5) EXECUTIVES AT ONLINE COMPETITORS

These four sources said their competitive strength stems from unique brand recognition and selling luxury and extremely high-end pet products unavailable at brick-and-mortar stores. All four agreed pet food offers slim margins and is expensive to ship, making hard goods, furniture, vitamins and other items the product of choice for e-tailers. Free shipping has become standard, but costs are added to product price. PetSmart faces growing competition from Whole Foods, Target and Wal-Mart working to expand their pet product SKUs, especially in premium pet food.

Source	Sales	Basket	Core Value Prop	Product	MAP	Shipping	PETM
1	Strong	Up	Owned by Vet	Own food	Not many imposed, rare in food, more hard goods	\$50 min for free	Customers trust us more
2	Up 30% in March	Up in # of items, transactions	High quality, eco-friendly	Hard goods focus, less food	Have not imposed MAP yet	\$100 min for free	PETM challenged by increase in comp from WFM
3	Up	\$57, up from \$45,		High end, exclusive	Benefit + curse, levels	\$50 min for free,	PETM not comp, should



	goal of \$75	less food	field, needs policing	considering \$75	be concerned re TGT, WMT
4	Flat	Price competitive, product selection	Hard goods over food	All free, built into price	PETM.com not good, educated customer a threat

➤ **1. Executive at a top-level website selling branded pet food and hard-good pet products**

Target, Wal-Mart and Amazon's Wag.com have continued to increase efforts to sell premium pet food in the last 18 to 21 months, adding new pressure to PetSmart's position in an already competitive market. Ranked among the top e-tailers for pet products, the source said his company has seen traffic, orders and sales increase over the same period. Growth stems from slow but steady economic recovery, consumer comfort with online purchasing and the website's optimized search and dynamic advertising. The website sells only a proprietary brand of premium dog and cat food, which also is available in select specialty stores, but also offers a varied product mix of hard goods.

- Online Strategy
  - "Our strategy for increasing online purchases relies on paid search at the top of the site and natural search at the bottom. We work to insure we place well in search when people use comparative shopping measures and are actively looking for a product to compare price points. I'm talking about consumers who use comparative shopping sites like [Nextag](#) and [Shopzilla](#)."
- Online Customer Profile
  - "The typical online customer is a mix of new consumers who are increasingly more comfortable online and people who are moving over from brick-and-mortar because they like the convenience and access to a broader selection of products and brands. The online buyer may also be migrating over to online because they can't find a certain high-quality product that they may have at boutiques. They can't find the specific product at the big-box because they don't carry it while the brick-and-mortar boutique may carry the desired item but it's much more expensive."
- Core Value Proposition
  - "Our website is highly competitive. We are one of the top online pet retailers. Our core value stems from being owned by veterinarians. We work with nutritionists and strive to provide education for pet owners. Because we are run by pet care experts, we are seen as trustworthy."
- Competition/PetSmart
  - "Whole Foods is not a major threat to PetSmart in part because they do not have a huge number of locations in the field and in contrast to PetSmart.
  - "Trust is the main reason customers purchase from us rather than PetSmart. They trust our brand, the price and over time have become loyal to us. But you need to have both a trusted brand and an acceptable price. If only one element is in place, the loyalty won't develop."
  - "PetSmart is definitely one of our online competitors, but we also have a very good relationship with them. It's respectful. They have a quality site and a recognizable brand. PetCo doesn't really need to sell online because they have many more store locations."
- Sales Trends
  - "We are doing well, and our traffic and sales are strong. The basket size is trending up, and we expect that trend to continue as people get more comfortable with purchasing goods on the Internet and as people, including those in the older demographic, start to rely more heavily on the iPad, smartphone and mobile devices."
- Basket Trends

The entry into higher-end pet food and products by Target and Wal-Mart and, for the online channel Wag.com, is an issue. The big-box stores have stepped up efforts in the last 18 to 21 months. They are growing their SKUs in the category of premium pet food. Wal-Mart is moving into higher-quality premium products.

*Executive, Top-level Website, Selling pet food & products*

- “Our basket size is up, and it has been steadily creeping up over the last 18 months as the economy has opened up. I’m not sure whether any other conditions in addition to an improved economy have been feeding the basket size.”
  - Product
    - “Our product mix is varied for hard goods and certain pet categories. But we only carry our own brand of premium dog and cat food, which was developed by our vets along with consulting nutritionists who helped us come up with a premium product. We have no trouble getting the same brands sold in brick-and-mortar stores.”
  - Premium Pet Food
    - “The entry into higher-end pet food and products by Target and Wal-Mart and, for the online channel Wag.com, is an issue. The big-box stores have stepped up efforts in the last 18 to 21 months. They are growing their SKUs in the category of premium pet food. Wal-Mart is moving into higher-quality premium products.”
  - Pricing
    - “Pricing is a mixed bag. Pricing is very much a function of perceived quality.”
  - MAPs, or minimum advertised price
    - “There aren’t that many MAPs imposed for the products we carry. They are rare in foods and more likely imposed on hard goods.”
  - Shipping
    - “Most of the obstacles to selling online have been removed. The most competitive aspect is the shipping cost. You are almost required, at this point, to offer free shipping for any order over \$49. Automatic shipping is a nice feature for repeat customers with regular monthly orders and after nine shipments, we offer the tenth one free.”
  - Bundling/Cross-selling
    - “Typically, we do not bundle hard-good purchases with other products. If you buy a pet bed, it is not bundled with a pet bowl. Cross-selling is more difficult to do online than it is in a catalog. We do have a list for online shoppers that might say people who bought product X also bought product Y. Or if you are buying a pet bed, we might add a feature that lets people know they may also like a matching item. We also have a feature that lets you see recently viewed items.”
- **2. Executive at a pet product e-retailer known for its own premium pet food and products**
- PetSmart faces threats from an array of competitors such as Target, Wal-Mart and Whole Foods. It has acknowledged the challenges and is working to counter market pressure by offering a higher-quality product mix and a broader selection of premium pet foods. Sales, traffic and basket spending are trending up for this Internet site, which offers its own premium pet food and pet products. The brand also is sold in specialty brick-and-mortar pet stores. Both online and offline pet stores are doing well now. The source’s company is supporting its website growth by investing in technology tools to enhance digital marketing and search.
- Online Strategy
    - “Our overall growth strategy has been very organic and driven by word of mouth, social media, search engine optimization [SEO] and search engine marketing [SEM]. We have a strong presence online and a nice niche.”
  - Core Value Proposition
    - “Our primary draw is our name and a brand known for high quality. People visit our website and buy our brand because of our established identity and our eco-friendly approach. Our brand is considered a luxury, upscale, designer product. Much of the brands cache is tied to our founder. She is charismatic and even in the early years she attended many industry market summits to promote the product, gain exposure and build the brand.”
    - “We appeal to consumers because our products are ecofriendly, and we sell across all categories.”
  - Competition/PetSmart

**The challenge they face from Whole Foods, Target and Wal-Mart is significant. They are up against consumers who go to these stores for convenience and one-stop shopping. Whole Foods has an added threat because you can get bulk foods and groceries along with organic and natural.**

*Executive, Pet Product E-retailer,  
Selling premium pet food & products*

- “PetSmart is selling higher-end products to more affluent customers. There is a concerted effort to incorporate the sale of more expensive, quality goods. Based on what I have read, PetSmart appears to be doing well.”
- “But I think they face added challenges because of the organic movement and the eco-friendly movement. At the same time the brick-and-mortars are under more intense scrutiny with regard to product purity and quality, in part because of the pet food scare that erupted a few years back.”
- “PetSmart seems to have acknowledged this challenge, and clearly they are aiming to get a larger offering of natural, organic products and higher end designer products.”
- “The challenge they face from Whole Foods, Target and Wal-Mart is significant. They are up against consumers who go to these stores for convenience and one-stop shopping. Whole Foods has an added threat because you can get bulk foods and groceries along with organic and natural.”
- “We actually have seen strength on both sides of the fence with growth at online pet websites and in brick-and-mortars. At this point there is no way to tell whether the growth online is coming from new customers or shoppers who are transferring from brick-and-mortar venues.”
- Basket Trends
  - “The average basket size is trending up in terms of the number of items per order and the number of transactions per month.”
- Product
  - “Our focus is on hard goods. We only sell our own branded food and treats. Our product mix includes everything from beds and toys to food and storage containers. We target the higher-end, discriminating consumer. The people we compete with in our space are also set up to sell less food and more hard goods, which seem to work best with online sales.”
  - “We also sell our pet food at brick-and-mortar stores, typically distributing through high-end specialty and independent pet stores. We do not place our products in the big-box stores like PetSmart.”
- MAPs
  - “We have the opposite situation with regard to MAPs. That is, we sell our own brand on our website but we also sell our food brand on other sites and at specialty retailers. We sell on Wag.com, for example. We have not imposed MAPs yet, and we have a good relationship with our brick-and-mortar sellers. We do provide a manufacturer’s suggested retail price.”
- Shipping
  - “One challenge for us is that many of the online stores ship for free or offer a two-day delivery for a fee. We do not offer free shipping on orders unless the basket spend is over \$100.”

➤ **3. Eric Houtkooper, president of [PupLife.com](http://PupLife.com), an online store selling luxury and designer pet products**

Premium pet food is a tough sell for online retailers because profit margins are low and shipping costs are high. More consumers are opting for exclusive, all natural/organic pet food brands, but the best manufacturers in the category avoid selling in PetSmart or chains. PupLife stopped selling all but a few pet food brands, and more fully focused on designer hard goods and its own website. PupLife sales jumped 30% in March after the changes. The average order tops \$57, up from \$45 a year ago. PupLife does not view PetSmart as a competitor. Rather, PetSmart’s public persona is stale, and the chain seems out of step with contemporary mobile and multidevice shopping behavior.

- Online Strategy
  - “When we started, we wanted to be the Whole Foods for dogs online. ... We very quickly learned why it is so hard to sell pet food online. There are incredibly low margins and the shipping costs are out of control. We then added hard goods, toys and treats and over time we have learned to do it better online, moving away from luxury pet foods and rebranding as a site that sells very high-quality designer goods and products that provide both functionality and benefit to both the dog and the

We very quickly learned why it is so hard to sell pet food online. There are incredibly low margins and the shipping costs are out of control. We then added hard goods, toys and treats, moving away from luxury pet foods and rebranding as a site that sells very high-quality designer goods and products. ... The average basket size totals \$57 per order; that’s up from \$45 per basket a year ago.

*President  
Online Luxury Pet Products Retailer*

- o dog owners. Now we don't do much in the way of designer dog food.
- o "Our strategy is all about branding awareness. To that end we recently rebranded. Our rebrand involves increased marketing, organizational growth and SEO."
- o "Our competitive position online is very strong right now. We sell items that are not available at brick-and-mortars or on other online sites. Our customers trust us to only carry the best of the best. If you are going to sell online you either have to be cheap or extremely unique."
- Online Customer Profile
  - o "The biggest barrier to online adoption is the age demographic. Most of our customers are females between the ages of 20 to mid-40s. They are affluent and have a dog that they baby and pamper. For many of the younger customers, they know of no other way to shop. One thing that seems to be helping with adoption is the use of tablets and mobile devices. We think the tablet will eventually take away the barriers for seniors and elderly."
- Competition/PetSmart
  - o "We don't view PetSmart or PetCo as competitors. People who buy at PupLife won't buy at PetSmart. Alternatively, the people who shop at PetCo and PetSmart may well buy certain items at PupLife. To the average consumer, PetSmart and PetCo are seen as being in the same space as Wal-Mart and Target."
  - o "PetSmart is facing a number of competitive threats right now, and they should be concerned as Whole Foods, Target and Wal-Mart expand into the pet product market. PetSmart is a mature brand, and it is perceived as such, even as online shopping grows. PetSmart has a branding problem or a perceived problem. They are getting hit in all areas, and it's extremely hard to turn it around. They need a better take on how people shop online."
  - o "It would be impossible for PetSmart to recruit most of the very high-end pet food companies because they don't want to be associated with PetSmart."
- Sales Trends
  - o "Our sales jumped 30% in March, and we attribute that to our rebranded site and collection of upscale luxury products that are in demand among a certain group of dog owners. But we also see that the economy is rebounding and people are starting to spend."
- Basket Trends
  - o "The average basket size totals \$57 per order; that's up from \$45 per basket a year ago. Our goal is to reach an average basket total of \$75 by next year."
- Product
  - o "We do carry some very high-end food as a service to our customers who want it. But we only sell very high-end brands that you won't find in PetSmart or PetCo. They might be in Whole Foods but not necessarily."
  - o "We find that a lot of the exclusive manufacturers and private labels will approach us to become part of our product mix. They know our site, know the quality of brands we sell and want to associate with the high-end designers."
  - o "We have the same access to the same premium brands as the brick-and-mortars, including the specialty shops, but we can't necessarily buy at the same price. ... That's why we changed our strategy on pet food, except for a few luxury brands that PetSmart can't carry."
- Premium Pet Food
  - o "The problem with selling high-end dog food [online] is that if you know the brand you like and you know the price, you can go online and comparison-shop. After that it's just a race to the bottom. The profit margin on dog food is really low; it's something like 10%. Shipping is a problem because of weight and freshness. We learned that it's best to let the offline, brick-and-mortar stores own the premium pet food space."
- Pricing
  - o "We have to price profitability into every item we sell, so our pricing strategy is to work in all of the costs from the drop shipping cost to packaging and postage. Some items generate a profit of 60%, and some

**PetSmart is facing a number of competitive threats right now, and they should be concerned as Whole Foods, Target and Wal-Mart expand into the pet product market. PetSmart is a mature brand, and it is perceived as such, even as online shopping grows.**

*President  
Online Luxury Pet Products Retailer*

have a profit level of no more than 10%. Shipping costs are always a problem, but they affect everyone equally.”

- MAPs
  - “We find the MAPs to be both a benefit and a curse. The larger companies do impose MAPs, and in general we favor the implementation of MAPs because they keep the playing field level. However, MAPs can hurt you if the manufacturer does not police them properly. We don’t have the time or personnel to police or follow whether others are abiding by the MAP so if we find that someone is not policing, we will drop that product.”
- Shipping
  - “Right now, we charge \$3.99 for all orders under \$50. All orders over \$50 are free. We also run free shipping specials. But we are thinking of changing our free shipping limit to \$75. The truth is, there is no free shipping. Nothing is free for the vendor, so covering the cost has to come from someone else. We try to be fair and competitive.”
- Bundling/Cross-selling
  - “We often recommend a collar if the customer is buying a leash. Or if they are going for a color scheme, we might recommend an item to match. It’s all determined by an algorithm for search. On the checkout page, we don’t have all the bells and whistles that Amazon has, yet. But the technology is getting cheaper by the day.”

#### ➤ 4. Cofounder of a high-end website that sells dog products

Premium and lower-end pet food is a difficult sell online, because of shipping costs and the built-in price add that makes online pricier than offline. The site is poised to expand current SKUs by adding exclusive food brands not sold in PetSmart. Exclusivity, selling brands unavailable offline, and the SEM and SEO tools have drawn customers to the site. Sales are up slightly year to year as consumer spending loosens. The average basket size is flat. Free shipping is standard for this website, although shipping/handling costs are built in to the price. PetSmart.com is a strong site with good functionality and graphics, but PetSmart stores are challenged by Whole Foods and other competitors in an expanding market.

- Online Strategy
  - “Our website does not compete with PetSmart.com.”
  - “In the dog product industry, margins are very low, so our success and viability will depend on volume. That is the case with hard goods, and that will also be the case with dog food. Our strategy is to be very price-competitive, and that is necessary to compete with the big boys.”
- Online Customer Profile
  - “The typical online customer is a mix of consumers migrating from brick-and-mortar and consumers who have a different set of characteristics than offline shoppers.”
- Core Value Proposition
  - “From the beginning we had to think through why anyone would buy from us online and the principle reason, we concluded, would be price.”
  - “If you can buy Blue Buffalo on our site but you also can buy it on 12 other sites and at any number of retail stores, why would anyone buy from our site?”
  - “Our strategy is to hand-select quality pet food brands, highly recommended by respected trade journals we trust. They would have the best ingredients. Even though dog food has smaller profit margins, we will be price-competitive.”
- Competition/PetSmart
  - “PetSmart’s online site is quite good. They have the staff and the money to stay current on technology. The site has easy navigation, it’s user-friendly and the graphics are uplifting. They have bright colors, but the hues are not overwhelming. The search feature on the site is good. When you have as many products as PetSmart you need good site search and search is expensive.”

As people get more educated about pet food ingredients and once the consumer realizes that what they feed their dog will directly impact future veterinarian bills, they’ll see that paying for the true premium brand [not sold in PetSmart] is not really more expensive over the long haul.

*Cofounder, High-end Website,  
Sells dog products*

- “The biggest competitive threat to PetSmart is the increasing education of the consumer with regard to premium pet food. The economy is in there too because many consumers are limited by their paycheck. But as people get more educated about pet food ingredients and once the consumer realizes that what they feed their dog will directly impact future veterinarian bills, they’ll see that paying for the true premium brand [not sold in PetSmart] is not really more expensive over the long haul.”
- “Most of the obstacles that prevent or discourage consumers from buying pet food online have been overcome. Educating the consumer about pet food is the only remaining barrier.”
- “We don’t compete with PetSmart, Wal-Mart or Target. Although we do have some product overlap, it’s no more than 5% to 8% of our offerings. The higher-end brands sold at PetSmart that are considered premium, including brands like Iams and Eukanuba, are really midrange in quality.”
- Sales Trends
  - “Traffic and transactions are increasing.”
- Basket Trends
  - “On average, we have not really seen a change in our basket size. Our merchandise is pretty expensive, and we are not indicative of the typical online pet retailer. But our unique, designer products are also the reason why people shop at our site, versus at a PetSmart.”
- Product
  - “Our product mix consists of furniture, beds and dog or cat houses, pet stairs, orthopedic beds, pet strollers and guard gates.”
  - “In terms of food, we will offer the absolute best quality, nutritionally balanced foods with pure ingredients.”
  - “Certain products are not practical or cost-effective to buy online, including the 40-pound bag of dog food or the 20-pound bag of [Swheat cat litter](#). I go to PetSmart when I need two bags of Swheat litter, but I buy my dog food at specialty boutiques that sell the best of the best.”
- Premium Pet Food
  - “The so-called premium brands at PetSmart are certainly better than supermarket quality. Science Diet is of the same caliber as Iams and Eukanuba, but the quality of their food processing and the quality and purity of the ingredients are not what I would want to sell.”
  - “But I am not your average buyer. I am in that top 2% of pet food shoppers who want to buy organic, all-natural and raw brands with the highest grade of ingredients. It is this segment of the premium pet food category that is growing the fastest and the most. But it’s also true that this is a small niche segment compared to everything else available.”
  - “We are just now in the planning phase of bringing in pet food, and the food we sell will be those highly recommended by [Whole Dog Journal](#). The food that interests me is not the dry or wet food that is sold in the traditional brick-and-mortars but the kind of premium food you would find in a high-end specialty pet boutique equipped with a freezer.”
- Shipping
  - “We offer free shipping on orders for all product categories, and we have just built the shipping cost into the overall price. We estimate the shipping cost and build that into the final price of the product.”

## 6) PREMIUM PET FOOD MANUFACTURERS

These seven sources said they have no intention or desire to sell their products in the mass retail channel, including at PetSmart; instead, they will remain with the independent and specialty stores. Independent producers typically reach the mass channel when purchased by a larger company seeking to improve its food quality. The market for premium pet food is growing rapidly in all channels. Premium’s share of the food market ranges from 6% to 60%, according to three sources who commented. Two sources who commented on sales reported growth year to year. Margins between premium and non-premium foods are similar. Likewise, price is not very different across channels, though product mix is determined by region. One source said PetSmart is less price-competitive, raising the profile of some premium brands that are no longer discounted.

Source	Sales	Margins	Premium Food	Pricing	Independent in Mass Stores in 18 months
1		Both 20%–30% PetCo gets 40%, PETM lower		PETM discounts 10%–15%	No
2	Up 30%	Premium gets 37%	Premium is 25% of market, sales growing	PETM less price competitive	No
3	Up, will keep growing	Premium at Sam’s Club 20%	Premium is 60% of market, sales growing	No price diff in channels; adjust mix	No, prefer specialty
4			Expanding demand	No price diff in channels	No, loyal to specialty
5					No
6					No, different audience
7		Both 20%–30%	Premium is 6%– 8% of market, growing slowly		Indies losing to PETM

➤ **1. Managing partner at a premium pet food manufacturer**

Despite the appeal of a big-box store, this source believes that premium lines like his own will never enter the mass market unless acquired by a larger company or investment firm. More than 60% of pet food owners still buy nonpremium pet food. Margins on premium food range from 20% to 35%, and PetCo does about a 40% gross margin on pet food, compared with independents, which try to make at least a 30% gross margin. PetSmart faces very little competition nationwide. Premium pet food prices remain the same across various retail channels.

- Margins
  - “Most all brands get 20% to 30% gross margin. In some boutique independent stores, you may see some premiums marked up to a 35% gross margin.”
  - “Your PetCos do about 40% gross margin on pet food. PetSmart will do much less as they try to be a discount store. Independents will try to make at least a 30% gross margin. Online retailers have to compete with the independents, and they just probably do a 30% gross margin and then try to offer no freight. It costs a huge amount. I do not see how any of them are making it. Right now I think they are burning dollars to create a base.”
- Pricing
  - “PetCo does not discount food, so there is no difference between PetCo mass and specialty. Online stores try to post pricing slightly less but add the freight, which makes the product higher than in stores. PetSmart is the real discount, and you can find brands selling 10% to 15% less than in specialty stores.”
  - “There is really no difference now in pricing for premium foods at various outlets. Eukanuba, Nutro Max, Science Diet and Blue Buffalo—and what I see as your commodity diets that are calling themselves ‘premium diets’—are just as high in price as your other premium diets in the independent stores. With the tremendous increase in the commodity products of grains and

I view independents as a stepping-off point to launch you into PetCo and PetSmart eventually, if that is where you want to go, and then you need to support that with a huge marketing budget to grow even a new following, because you are going to lose a good percentage of your sales from the independents once you go into the big-box stores.

*Managing Partner  
Premium Pet Food Manufacturer*

protein meals, and marketing budgets, these companies have had to really raise their prices on those supposedly high-end commodity brands.”

- Different Channels
  - “Premium lines ... you will never see any of those in mass markets until they are bought by a company.”
  - “You only have a competitive threat against PetSmart in a few select markets. Many independent stores do not carry the same products. There are a few strong pet stores in Ohio, Michigan, Texas. But they are not really a great threat to the PetSmart plan.”
  - “I view independents as a stepping-off point to launch you into PetCo and PetSmart eventually, if that is where you want to go, and then you need to support that with a huge marketing budget to grow even a new following, because you are going to lose a good percentage of your sales from the independents once you go into the big-box stores.”
  - “Products like ours, you will never see in grocery stores. If you put your product in a grocery stores, independents will drop you like flies.”
  - “A lot of independents are getting tired. That happens to small independents. But as far as being strong in the market, I think independents will always be around.”
  - “Small, independent stores feel like they are responsible for building startup brands. And then once that startup leaves and goes to PetCo or PetSmart, they feel betrayed, and a lot of them will stop emphasizing the product line.”
  - “I have been told by most wholesale distributors that Procter & Gamble, after they went into PetCo, lost overall about 30% to 40% of their sales, which were not made up by going into PetCo.”
- Consumers
  - “Most of your consumers will go by perception, and that is built through marketing. Most consumers will not bother to really try to understand whether the product is actually quality ingredients. ... There is a huge population that is totally swayed by perception.”

## ➤ 2. Owner of a holistic-focused pet food manufacturing company

Pet owners and caretakers have an obligation to know what is in their pets’ food, and it is this source’s mission to make holistic, high-quality dog and cat food that uses mostly U.S. ingredients. He is competing against an industry that allows sales of so-called premium foods with very little investigation, but sales of his premium pet food—sold mostly in independent stores, veterinary offices and online—are up significantly. He believes other manufacturers will continue to pursue the big-box route, which is not as taboo as it once was. PetSmart has gotten smarter on its pricing, raising lower and midlevel foods to keep pace with independents. PetSmart’s main rivals are Target and Wal-Mart, both of which have started to carry higher-quality pet items.

- Sales Trends
  - “The shift of people buying premium products occurred after the pet food recall, and we are seeing a continuing trend in that direction.”
  - “Once consumers know the quality of the food, it seems that there is still a viable market in the upper end. We experienced 30%-plus growth in our distribution center, which is huge. It is hard to manage that growth.”
  - “We have continued to expand with pretty significant growth, 30% to 40% growth.”
  - “When the dog food recall hit in 2007, we had low-, midrange and high-end foods. Consumers in the middle moved up. During the past four years, the midlevel has taken a big hit. But one of the most expensive, holistic, super premium foods has had growth rates of 90% to 100%—and this is over the past four years in one of the worst economies in years.”
- Margins
  - “At the retail level, the normal markup for premium pet food is 37%.”
  - “Gigantic margins can be made in pet food if you have low-end ingredients.”
- Premium Pet Food

**At the retail level, the normal markup for premium pet food is 37%. ... The premium market is probably 25% to 30% of the pet food sold. ... The percentage of consumer spend on premium food is trending up.**

*Owner, Holistic-focused Pet Food Manufacturing Company*



- “The term ‘premium’ is self-proclaimed. There is no standard that says you are a premium or a non-premium product and anyone can make that claim that they are a super-premium, holistic food. There is such a wide range of acceptable ingredients.”
- “The premium market is probably 25% to 30% of the pet food sold.”
- “The percentage of consumer spend on premium food is trending up.”
- “On the low-end, some manufacturers have simply relabeled their foods as holistic and super-premium. They raised the price to the low end of the threshold of what really good quality would cost. They make significant margins on it, and consumers and pets are not getting anywhere near the quality.”
- Pricing
  - “The cost for ingredients is what drives the price. The only way to reduce costs is to cut quality.”
  - “PetSmart and PetCo have become less price-competitive than they once were. They have become wiser about their pricing. A higher price at PetSmart and PetCo gives that brand credibility and independent retailers are less likely to get rid of the brand.”
- Different Channels
  - “Manufacturers always are likely to sell through mass channels. Manufacturers start small, produce quality, and build a following with brand recognition—and then they sell out. And the people that buy them out, like Procter & Gamble and Mars, reduce quality.”
  - “One of the primary considerations of independent retailers is what is a manufacturer’s position of selling to national chains because so many brands have done it over the years. They want it in writing that you will not sell to PetSmart or PetCo.”
  - “In any big-box stores, as a general rule, employees promote the manufacturers’ sales program. They never discuss that it may be produced with low-grade materials.”
  - “But when you get into an independent market, that dealer is in business because they have a greater passion or a long family business. And typically the knowledge is higher.”
  - “It is 0% likely that I will sell my products via the mass channel. They charge manufacturers for the promotional fliers, signs, advertising. If you do not pay into the marketing budget, they reduce the shelf space or move you out of the store. Once you go there you lose their support.”
  - “PetSmart’s business is good and competitive threats are national chains like Target and Wal-Mart that are offering better quality. PetSmart, Wal-Mart and Target offer the same.”
  - “Independent retailers are not losing business. Some retailers are trying to find locations close to PetSmart where there is an already developed customer base. Many pet owners shift their business over to a store that is more knowledgeable about where products are sourced.”
  - “The online component is not that important to me as a manufacturer. With online stores, it is strictly convenience.”

### ➤ 3. Vice president of a domestic manufacturer of premium, natural and organic pet foods

Genuinely premium pet food manufacturers are less likely to sell their high-end products in the mass market, fearing the banality of a chain/big-box store such as PetSmart would undermine the luxury status of their brand. More often than not, the Procter & Gambles of the world acquire the premium pet food and/or its manufacturer once it gains momentum at specialty stores. Wal-Mart and Target do not pose a threat to PetSmart at this time. The product mix is shifting, with premium pet foods taking share from lower-priced value brands. This source could not speak to ordering trends at PetSmart but said pet food orders from specialty stores are steadily rising. PetSmart could gain over PetCo if it leveraged the one-stop benefits of the chain’s retail offerings, onsite veterinary hospitals and grooming salons.

- Sales Trends
  - “I can’t really help you with regard to same-store dollar sales and same-store replenishment orders at PetSmart. We do not sell our premium brands there. What I can tell you is that the same-store dollar sales and same-store replenishment orders for our existing specialty store customers have increased, and the trend appears to be continuing upward.”
- Margins
  - “Target and Wal-Mart have much lower margins on premium pet food products. But in the big-box market, a company like [Wal-Mart’s] Sam’s Club can work an 18% to 20% margin on a \$40 bulk bag of premium food.”
- Premium Pet Food

- “We have seen changes in the product mix. The premium brands are growing quickly, and the trend suggests continuing strength for the high-end premium and luxury brands. The split used to be 60% versus 40%, value to premium brand; now the product mix has reversed with 60% of consumers buying premium and 40% or less buying for value.”
- Different Channels
  - “PetSmart and PetCo are not in the same space as Wal-Mart and Target. People buy at Wal-Mart and Target for the price and the value. Among pet owners, PetSmart is a higher-end experience than Wal-Mart offers. That won’t change unless they get behind selling premium products in a big way. Right now Wal-Mart and Target are the loss leaders. They do have some premium offerings, but they are premium in contrast to the standard fare at Wal-Mart and Target.”
  - “There is a certain segment of the market share consumer that wouldn’t touch any pet food sold by the publicly traded companies such as PetSmart and PetCo. They don’t view these chains as having a family-oriented approach to pets, now seen by many as a family member. This segment is migrating to the pet specialty stores and independents where they can get handholding and advice on the very high grade products.”
  - “We do not sell our high-end premium products at PetSmart. We do sell our products indirectly to PetSmart on a third-party contract basis. But that is not the core of our business. When it comes to Pet Smart and PetCo, we try to stay out of the way of the Purinas and Proctor & Gambles. And we do just fine without them, selling a couple of hundred million dollars a year through the pet specialty channel. I’m talking about the independent, boutiques and small chains with 10 or so stores.”
  - “Very few of the true premium-brand pet food manufacturers attempt to sell in the mass-market channel. If a premium brand becomes popular within the specialty/boutique pet store segment, it does not then necessarily transition into PetSmart. What typically happens is that one of the larger consumer product manufacturers acquires the premium pet food brand and takes them into the chains.”
  - “With the humanization of pets and their incorporation into the family unit, everyone stands to gain. The mass-market stores like Pet Smart and PetCo, the small regional independent chains, the single unit boutiques, and the online retailers can all do well.”
- PetSmart
  - “What I like about PetSmart versus PetCo is that they are not just a pet food, pet product store. They also have in-store veterinary services through Banfield hospitals, which includes boarding and healthcare, and they have grooming salons onsite. That gives PetSmart an opportunity to leverage an edge other brick-and-mortars do not have.”

We have seen changes in the product mix. The premium brands are growing quickly, and the trend suggests continuing strength for the high-end premium and luxury brands. The split used to be 60% versus 40%, value to premium brand; now the product mix has reversed with 60% of consumers buying premium and 40% or less buying for value.

*VP, Premium Organic Pet Foods  
Manufacturer*

#### ➤ 4. Vice president of marketing at a nationally distributed pet food manufacturer

Today’s pet owners increasingly are buying natural, holistic and grain-free foods. The source’s company does not price its premium food differently for various retail outlets, but instead tailors prices to the area’s consumer demographic. The company manufactures premium pet foods as well as one brand that is not considered premium and is sold in grocery stores. She does not expect her company to sell its product in PetSmart or PetCo in the next 18 months.

- Premium Pet Food
  - “There is a shift in the types of products pet owners are buying today. We see our natural, holistic and grain-free foods expanding due to customer demand with the biggest demand being for our grain-free formulas.”
- Pricing
  - “We do not price our premium food differently at different types of locations, but we place the appropriate product lines

It is not likely that we will sell through mass channels in the next 12 to 18 months.

*VP of Marketing  
National Pet Food Manufacturer*

in the appropriate type of location with price point reflecting the type of customers that shop the location.”

- Different Channels
  - “We try to stay loyal to our pet specialty stores by not selling to mass market. We have specific brands for grocery and feed stores, etc.”
  - “It is not likely that we will sell through mass channels in the next 12 to 18 months.”
  - “We sell mostly to independent stores and pet chains, not big-box stores. We have a grocery line of food, but it is not considered premium. Our food is sold online but not through us.”

## ➤ 5. Veterinarian for a major pet food manufacturer

PetSmart and PetCo already carry premium pet food, but this source does not expect therapeutic product manufacturers to go the mass-market route. PetSmart is ordering more natural foods. She believes independent chains, mass-market retailers and online retailers cater to different clientele, though pricing differences for premium foods sold at these various outlets do not vary greatly.

- Pricing
  - “There is no significant difference in premium pet food prices at these various outlets.”
- Different Channels
  - “The premium wellness products are sold in PetSmart and PetCo. Therapeutic products will not be sold through mass channels.”
  - “Independent chains, mass market retailers and online channels manage different types of clientele.”
- PetSmart
  - “PetSmart is ordering more naturals, following the current trend.”
  - “PetSmart has a very good business model.”

## ➤ 6. Marketing director for a raw food manufacturer

Online retailers pose the biggest threat to big-box retailers like PetSmart and PetCo. Independent stores and chains are key to educating consumers about raw food products. For that reason, this source does not expect premium retailers to flock to big-box stores in the coming year. His company chooses to work with independent and online retailers.

- Different Channels
  - “We believe the independent and small chains play an important role in consumer education of the raw frozen and freeze-dried segments, and an important part of the decision-making and purchasing decisions for differentiated products.”
  - “It is unlikely that premium pet food manufacturers will sell through mass channels like PetSmart and PetCo in the next 12 to 18 months.”
  - “The decision to not compete in big-box retailers is our choice. Given the audience we target, we feel these consumers are more likely to shop in other channels that better meet their needs.”
  - “E-commerce represents the biggest threat to big-box pet retailers, much like has occurred with other categories like electronics and books.”

**The decision to not compete in big-box retailers is our choice. Given the audience we target, we feel these consumers are more likely to shop in other channels that better meet their needs.**

*Marketing Director  
Raw Food Manufacturer*

## ➤ 7. Owner of a premium pet food company

Big-box stores are hurting independent retailers. Larger chains like PetSmart can force pet food producers to cut quality of ingredients in order to protect margins. PetSmart also requires high ad spending for brands on its shelves. This source does not plan to enter that mass market.

- Margins
  - “Bigger stores that handle the food typically can margin the food down so much that the producer has to cut everything, including quality of ingredients, to be able to make it.”
  - “The typical markup for premium pet foods is maybe 20% to 30%. Much below that and you do not survive. Grain-free

**The typical markup for premium pet foods is maybe 20% to 30%. Much below that and you do not survive. Grain-free foods are higher than that because of perception, not ingredients. ... The typical margins on premium and nonpremium pet food are the same—about 20% to 30%.**

*Owner, Premium Pet Food Company*

- o foods are higher than that because of perception, not ingredients.”
- o “The typical margins on premium and nonpremium pet food are the same—about 20% to 30%.”
- Premium Pet Food
  - o “I bet 6% to 8% of consumer spend is on premium pet food. There is a slow increase in that segment.”
- Different Channels
  - o “Independent retailers are definitely losing at the expense of PetSmart and PetCo.”
  - o “Once you grow so big in one market, the companies typically move onto the next: independents, then big-box, then online. It’s not likely for us to sell in the big-box stores. They want lots of ad money behind the brand, and I am small.”

---

Additional research by Scott Martin, Cheryl Meyer, Carolyn Marshall, Colin Gustafson, Kevin Murphy, Tina Strasser, Cindy Elsberry, Ken Turetzky, David Franklin and David Friedman

The Author(s) of this research report certify that all of the views expressed in the report accurately reflect their personal views about any and all of the subject securities and that no part of the Author(s) compensation was, is or will be, directly or indirectly, related to the specific recommendations or views in this report. The Author does not own securities in any of the aforementioned companies.

OTA Financial Group LP has a membership interest in Blueshift Research LLC. OTA LLC, an SEC registered broker dealer subsidiary of OTA Financial Group LP, has both market making and proprietary trading operations on several exchanges and alternative trading systems. The affiliated companies of the OTA Financial Group LP, including OTA LLC, its principals, employees or clients may have an interest in the securities discussed herein, in securities of other issuers in other industries, may provide bids and offers of the subject companies and may act as principal in connection with such transactions. Craig Gordon, the founder of Blueshift, has an investment in OTA Financial Group LP.

© 2013 Blueshift Research LLC. All rights reserved. This transmission was produced for the exclusive use of Blueshift Research LLC, and may not be reproduced or relied upon, in whole or in part, without Blueshift’s written consent. The information herein is not intended to be a complete analysis of every material fact in respect to any company or industry discussed. Blueshift Research is a trademark owned by Blueshift Research LLC.