

Petco

Card Data Shows 4Q Sales Growth For WOOF

Reiterate Rating: BUY | PO: 5.00 USD | Price: 2.60 USD

WOOF observed sales trends accelerate into 4Q

Bloomberg Second Measure credit and debit card data shows that observed sales for WOOF (96% correlated with company-reported net sales growth) accelerated into 4Q (Exhibit 2). WOOF observed sales growth throughout 4Q continued to reflect higher y/y transactions that were partially offset by declines in avg. transaction value (Exhibit 1).

Making the right moves in a soft demand backdrop

We are modeling same-store sales of -1.5% in 4QE as WOOF operates in a challenging macro environment where pet owners are being more discerning with their spending. In 3Q, WOOF reported flat comps with consumables up 2% y/y, but the more discretionary supplies and companion animal businesses were down 9% y/y. There's been a "hollowing out of the middle" where certain consumers are trading down to value brands while others are trading up to super premium and fresh/frozen foods. WOOF has thoughtfully responded to this by adding more value brands while maintaining its more premium offerings and focus on pet health and wellness; and is encouraged that so far baskets with value products have been the same size.

Risks have risen, but shares are more than pricing them in

Given WOOF's market position and valuation (currently trading ~11x F24E P/E), we reaffirm our Buy \$5 PO based on our F24E P/E of 17x, which is more in line with the hardline retail average. While we see continued pressure on margins (from mix shifts to value, ecommerce and lower margin product categories) and interest expense, we see support for WOOF long-term as its new value-oriented brands broaden its customer base and grow sales with existing customers seeking value (while WOOF retains share at the higher end of the market). Moreover, WOOF continues to invest in rolling out vet hospitals (a 20% increase this year), eventually reaching 900 stores, which is a key differentiator versus online competitors – though it should take time for WOOF's service offerings to contribute more meaningfully to earnings.

Estimates (Jan) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	0.79	0.61	0.08	0.29	0.62
GAAP EPS	0.62	0.34	(4.67)	0.29	0.62
EPS Change (YoY)	132.4%	-22.8%	-86.9%	262.5%	113.8%
Consensus EPS (Bloomberg)			0.08	0.09	0.24
DPS	0	0	0	0	0
Valuation (Jan)					
P/E	3.3x	4.3x	32.5x	9.0x	4.2x
GAAP P/E	4.2x	7.6x	NM	9.0x	4.2x
EV / EBITDA*	6.9x	7.1x	9.3x	8.2x	6.6x
Free Cash Flow Yield*	19.9%	11.4%	-10.1%	10.6%	26.7%

* For full definitions of *IQmethod*SM measures, see page 6.

01 March 2024

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Stock Data

Price	2.60 USD
Price Objective	5.00 USD
Date Established	29-Nov-2023
Investment Opinion	C-1-9
52-Week Range	2.34 USD - 10.76 USD
Mrkt Val (mn) / Shares Out (mn)	598 USD / 230.0
Free Float	34.7%
Average Daily Value (mn)	8.63 USD
BofA Ticker / Exchange	WOOF / NAS
Bloomberg / Reuters	WOOF US / WOOF.OQ
ROE (2024E)	1.0%
Net Dbt to Eqty (Jan-2023A)	60.9%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

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Refer to important disclosures on page 7 to 9. Analyst Certification on page 5. Price Objective Basis/Risk on page 5.

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Timestamp: 01 March 2024 08:59AM EST

iQprofileSM Petco

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	4.7%	4.0%	1.8%	3.0%	4.4%
Return on Equity	9.7%	7.0%	1.0%	3.5%	7.2%
Operating Margin	5.9%	5.1%	2.7%	37.5%	38.5%
Free Cash Flow	119	68	(61)	63	160

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.7x	2.1x	7.0x	3.6x	2.3x
Asset Replacement Ratio	1.4x	1.4x	1.1x	1.1x	1.0x
Tax Rate	27.5%	27.8%	41.6%	26.0%	26.0%
Net Debt-to-Equity Ratio	64.3%	60.9%	67.2%	66.5%	53.7%
Interest Cover	4.5x	3.0x	1.1x	1.7x	2.7x

Income Statement Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	5,807	6,036	6,230	6,230	6,417
% Change	18.0%	3.9%	3.2%	0%	3.0%
Gross Profit	2,427	2,427	2,354	2,339	2,470
% Change	15.1%	0%	-3.0%	-0.7%	5.6%
EBITDA	548	531	406	464	575
% Change	11.3%	-3.2%	-23.4%	14.2%	23.9%
Net Interest & Other Income	(77)	(101)	(150)	(135)	(121)
Net Income (Adjusted)	209	163	23	79	166
% Change	192.7%	-22.3%	-86.0%	247.1%	110.3%

Free Cash Flow Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	160	90	(1,252)	79	166
Depreciation & Amortization	172	194	206	206	212
Change in Working Capital	(476)	(427)	(15)	(1)	2
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	502	489	1,220	0	0
Capital Expenditure	(239)	(278)	(220)	(220)	(220)
Free Cash Flow	119	68	-61	63	160
% Change	9.2%	-42.9%	NM	NM	152.6%
Share / Issue Repurchase	0	4	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	9	(17)	(72)	(75)	0

Balance Sheet Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	212	202	85	73	233
Trade Receivables	56	50	51	51	53
Other Current Assets	804	765	799	778	790
Property, Plant & Equipment	727	803	818	832	840
Other Non-Current Assets	4,700	4,794	4,765	4,765	4,769
Total Assets	6,498	6,613	6,518	6,500	6,686
Short-Term Debt	22	23	23	23	23
Other Current Liabilities	1,031	998	1,020	1,021	1,036
Long-Term Debt	1,640	1,628	1,557	1,532	1,507
Other Non-Current Liabilities	1,549	1,582	1,696	1,696	1,708
Total Liabilities	4,242	4,231	4,295	4,271	4,274
Total Equity	2,256	2,381	2,223	2,228	2,412
Total Equity & Liabilities	6,498	6,613	6,518	6,500	6,686

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Retailing-Hardlines

Company Description

Petco Health & Wellness Co owns and operates about 1,430 stores as of YE2022, offering pet supplies, companion animals (small birds, reptiles, fish, and small rodents), and services (grooming, training, in-store vaccination clinics, and more recently in-store full-service veterinary hospitals at 247 locations as of YE22). It is one of the largest chains in the specialty pet supply channel.

Investment Rationale

We view Petco as an industry leader in meeting the needs of pets and pet parents with a cohesive omnichannel approach. Although growth in lower-margin channels (online, and services in particular), is expected to outperform in-store merchandise sales growth, potentially pressuring margin expansion, we think adjusted EBITDA growth should approach a rate at the high end of the high-quality retailer comp set. Valuation remains attractive relative to hardline and animal health peers.

Stock Data

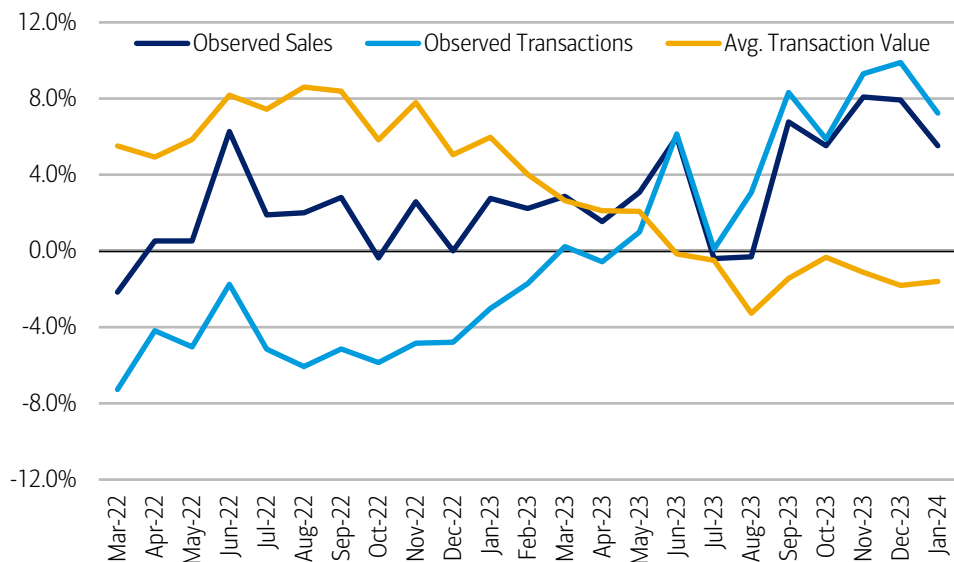
Average Daily Volume 3,314,951

Quarterly Earnings Estimates

	2023	2024
Q1	0.14A	0.06A
Q2	0.16A	0.06A
Q3	0.11A	-0.05A
Q4	0.20A	0.02E

Exhibit 1: Mid-to-high single-digit% observed sales for WOOF in 4Q (Nov.-Jan.) reflected higher y/y observed transactions, partially offset by y/y declines in avg. transaction value

Bloomberg Second Measure credit & debit card data – Monthly Observed Sales, Observed Transactions & Avg. Transaction Value

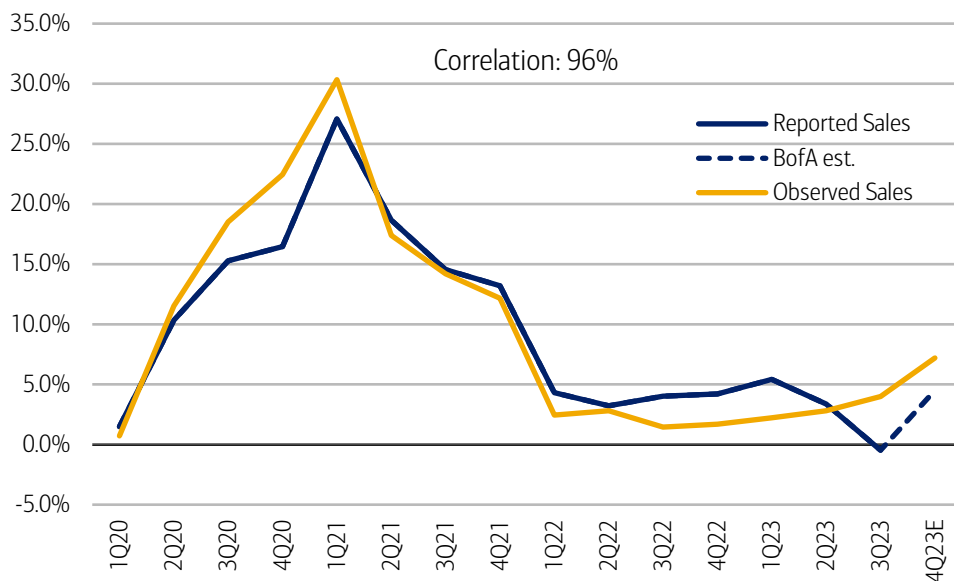


Source: Bloomberg Financial LP – ALTD <GO>, BofA Global Research

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Exhibit 2: WOOF observed sales have accelerated in 4Q, which is in line with our forecast for an acceleration in net sales for 4QE (incl. expected benefits from extra week)

Bloomberg Second Measure credit & debit card data – Observed Sales (vs. WOOF reported sales)

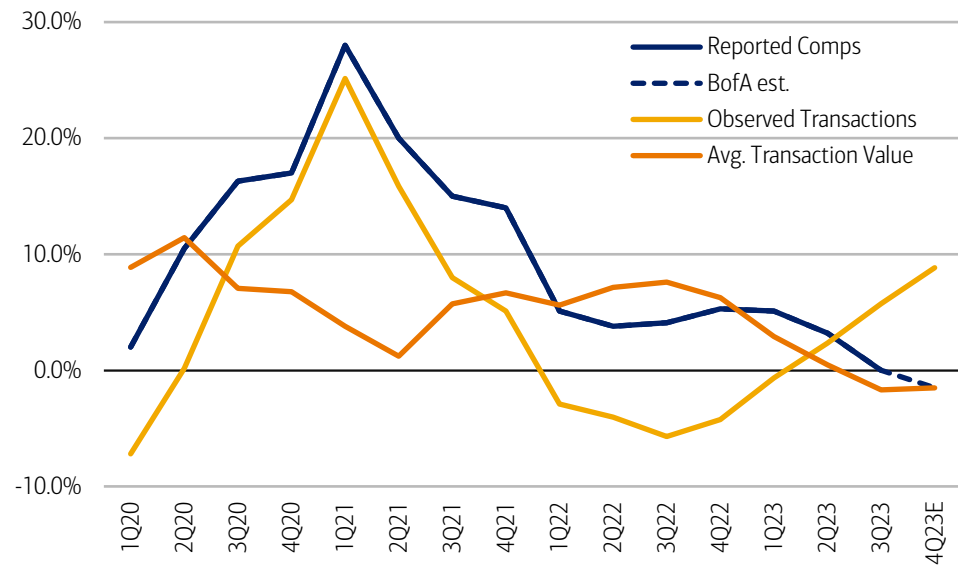


Source: Bloomberg Financial LP – ALTD <GO>, company filings, BofA Global Research estimates

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Exhibit 3: The improvement in WOOF's observed sales in 4Q was driven by a pickup in observed transactions

Bloomberg Second Measure credit and debit card data – Observed Transactions & ATV (vs. WOOF reported same-store sales)



Source: Bloomberg Financial LP – ALTD <GO>, company filings, BofA Global Research estimates

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Price objective basis & risk

Petco (WOOF)

Our price objective of \$5 is based on a P/E of 17x our 2024E, in line with the average hardline retailer and a discount to animal care companies given the relatively small portion of WOOF's sales comprised by vet services currently.

Downside risks are 1) margin dilution from faster-growing online sales and services compared to in-store merchandise, 2) recession risk that could cause a reversal of the premiumization trend that has been in place for the last decade, 3) execution risk from the rapid rollout of vet hospitals, and 4) increased competition in services.

Upside risks are 1) elevated levels of pet demand for longer than expected, resulting in a larger pet population and greater demand for products and services, and 2) initial success in the vet hospital rollout leading to an acceleration in the planned pace of new locations.

Analyst Certification

I, Jason Haas, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Retail Hardline Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Arhaus, Inc.	ARHS	ARHS US	Jason Haas, CFA
	Boot Barn	BOOT	BOOT US	Jason Haas, CFA
	Driven Brands	DRVN	DRVN US	Jason Haas, CFA
	Five Below Inc.	FIVE	FIVE US	Jason Haas, CFA
	Floor and Decor Holdings, Inc.	FND	FND US	Robert F. Ohmes, CFA
	Genuine Parts	GPC	GPC US	Jason Haas, CFA
	Lowe's Companies, Inc.	LOW	LOW US	Robert F. Ohmes, CFA
	Mattel	MAT	MAT US	Jason Haas, CFA
	Mister Car Wash	MCW	MCW US	Jason Haas, CFA
	Ollie's	OLLI	OLLI US	Jason Haas, CFA
	O'Reilly Automotive, Inc.	ORLY	ORLY US	Jason Haas, CFA
	Petco	WOOF	WOOF US	Jason Haas, CFA
	PROG Holdings Inc	PRG	PRG US	Jason Haas, CFA
	Rollins Inc.	ROL	ROL US	Jason Haas, CFA
	Tempur Sealy International Inc.	TPX	TPX US	Jason Haas, CFA
	The Home Depot, Inc.	HD	HD US	Robert F. Ohmes, CFA
	Upbound Group Inc.	UPBD	UPBD US	Jason Haas, CFA
NEUTRAL				
	AutoZone Inc.	AZO	AZO US	Jason Haas, CFA
	Hasbro	HAS	HAS US	Jason Haas, CFA
	Sonos, Inc.	SONO	SONO US	Jason Haas, CFA
	Williams-Sonoma	WSM	WSM US	Jason Haas, CFA
UNDERPERFORM				
	Advance Auto Parts, Inc.	AAP	AAP US	Jason Haas, CFA
	Best Buy Co., Inc.	BBY	BBY US	Robert F. Ohmes, CFA
	Snap-on	SNA	SNA US	Elizabeth L Suzuki
	Tractor Supply Company	TSCO	TSCO US	Jason Haas, CFA
	Whirlpool	WHR	WHR US	Jason Haas, CFA



iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

Basic EBIT + Depreciation + Amortization

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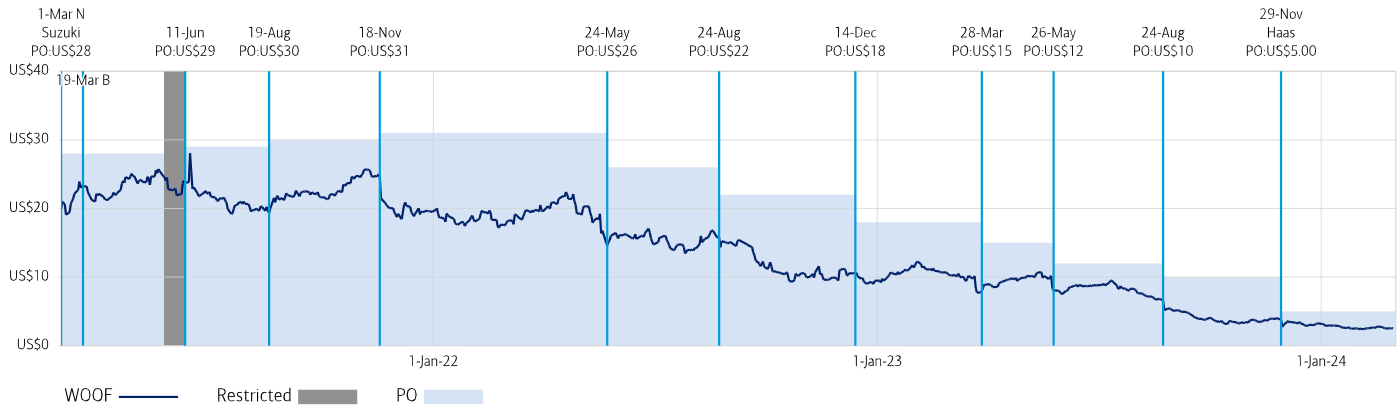
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Petco (WOOF) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Retailing Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	96	57.83%	Buy	39	40.63%
Hold	32	19.28%	Hold	12	37.50%
Sell	38	22.89%	Sell	18	47.37%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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