

## Chewy Inc

# Takeaways from pet expert call: expect soft pet trends to continue in 2024

Maintain Rating: UNDERPERFORM | PO: 17.00 USD | Price: 17.39 USD

## Adoption recovery potentially 8-12 months out

We hosted a call with Dominic Strada, Chief Sales Officer of Compana Pet Brands and formerly Vice President of Purina's Pet Specialty division. While pet adoption rates are soft on a YoY basis with Petfinder.com web traffic declining 27% YoY in Feb (though Similarweb indicates traffic is inline with 2019 levels on an absolute level basis), our expert believes an inflection in trends is still likely 8-12 months out. Headwinds to adoption rates include: 1) pet ownership is still relatively high given approx. 2mn more homes own pets vs. 2019; 2) pet inflation is up 20%+ vs. 2019 (and overall inflation is still eating into the consumers' wallets elsewhere); 3) lifestyle shifts post-reopening; and 4) a slower and/or smaller pet replacement cycle. Despite pet inflation cooling to 1.7% YoY in February, Mr. Strada believes that overall inflation still needs to come down in other areas of core spend before pet adoption trends inflect.

## Pricing no longer driver of growth; innovation needed

Mr. Strada believes that pricing had largely been able to mask negative volume trends in the industry until recently. However, while pricing is no longer a tailwind, Mr. Strada has not seen significant trade down activity thus far, at least more premium parts of the market. If prices were to come down in the next 12 months, Mr. Strada believes that this would ultimately come from vendor-sponsored discounting (more on subscribe-and-save, rather than price markdowns, to avoid diluting brand equity). Since 2019, manufactures increased capacity in the market roughly 5%+, and so we think it is reasonable that manufacturers would be willing to fund promotions to increase utilization. According to Mr. Strada, another catalyst to reaccelerate the pet industry could be innovation, which has lulled recently and following the natural food category was introduced in the mid-2010s, per Nielsen. Mr. Strada estimates innovations in the pet industry occur every 10-15 years, and, while innovation is inherently unpredictable, the next trend is likely to extend a product's value proposition (i.e. dental treats).

## eCommerce channels winning, with WMT/AMZN leading

Placer.ai indicates foot traffic to PetSmart for the week ending 3/3 is down 7% YoY as brick-and-mortar pet specialty retailers struggle to attract customers. According to our expert, pet specialty brands largely failed to adapt to changing trends post-COVID as effectively as eCommerce platforms, which continue to win share as the pace of Online penetration growth normalizes (we est. penetration to expand around 100bps y/y in '24). Within Online, our expert believes Walmart and Amazon are best-positioned to capture incremental share while the pet industry remains pressured, with 1) consumers focused on value pricing & convenience (one-stop-shop) and 2) significant merchandising improvements over the last few years to build up pet assortments (especially for Walmart). In our expert's view, Chewy's historically winning formula of high service levels and catering to the emotions of pet ownership through birthday cards & flowers to mourn a loss pet may not be prioritized as much in this environment as customers seek value deals. However, our expert did note that Chewy has shifted strategies before, and to not fully count Chewy out. Chewy reports earnings after-market on 3/20 (see report: [4Q Preview](#)). Maintain Underperform rating on Chewy.

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### Stock Data

Price	17.39 USD
Price Objective	17.00 USD
Date Established	10-Jan-2024
Investment Opinion	C-3-9
52-Week Range	15.78 USD - 40.78 USD
Mkt Val (mn) / Shares Out (mn)	7,467 USD / 429.4
Free Float	82.7%
Average Daily Value (mn)	132.26 USD
BofA Ticker / Exchange	CHWY / NYS
Bloomberg / Reuters	CHWY US / CHWY.N
ROE (2024E)	77.4%
Net Dbt to Eqty (Jan-2023A)	-154.4%
ESGMeter™	Low

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AMZN: Amazon

WMT: Walmart

## Price objective basis & risk

### Chewy Inc (CHWY)

Our PO of \$17 is based on 0.5x 2025E EV/Sales, discount to our eCommerce and Pet Specialty comp group at 1.1x. We believe a discounted is warranted given lower forecast revenue growth to peers and significantly lower margins.

Upside risks: 1) room for long-term margin expansion driven by adjacent services, advertising, shifting product mix, and building out automated fulfillment centers 2) Chewy's Autoship driving durable and higher-growth sales and 3) expansion of adjacent service such as private brands, pharmacy, and insurance increasing NSPAC headroom, with mgmt. noting NSPAC lift of \$200-\$300/yr by adding pharmaceuticals.

Downside risks: 1) pet spend growth has dramatically slowed on a weak macro and low pet adoption rates which we expect to pressure Chewy growth through 2024, 2) Chewy's expansion into Canada is a distraction from margin improvement and is may not be a material revenue given a much smaller pet market and 3) moderating inflation and promotions decelerating pricing gains of the past 18 months.

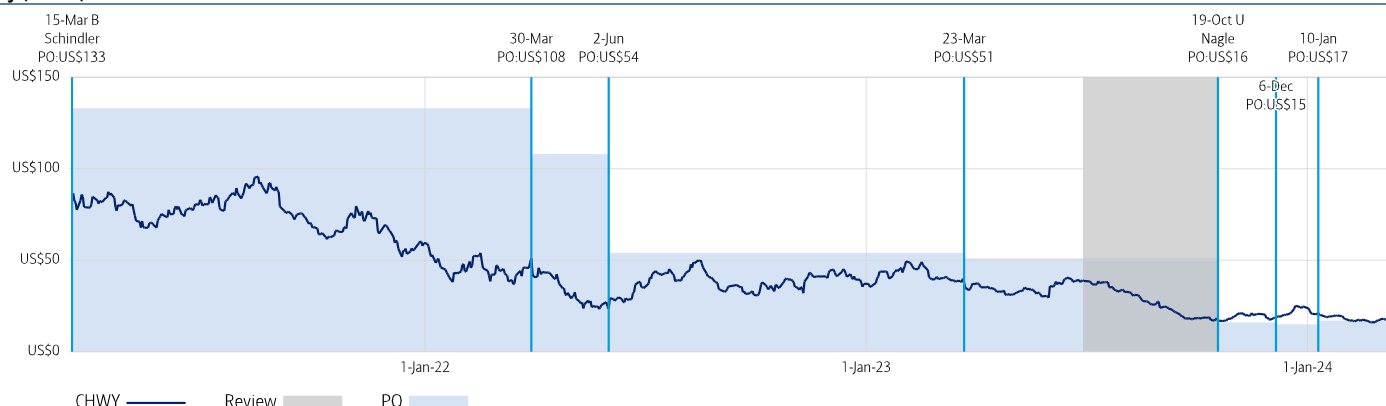
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### Chewy (CHWY) Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

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