



OurPet's Company(OPCO)

Initiate Coverage of OurPet's Company With A \$4 Price Target

	2015	2016	2017E	2018E
Mar.	\$0.01	\$0.01	\$0.02	\$0.04
June	0.01	0.01	0.02	0.03
Sep.	0.02	0.02	0.04	0.05
Dec.	0.02	0.06	0.07	0.08
EPS	\$0.07	\$0.11	\$0.15	\$0.19
P/E			7.9x	6.4x

Note: NR = Not Rated. Risk Ratings: H = Highly risky; M = Moderately risky. Sum of quarterly data may not equal full-year total due to rounding and/or changes in the share count. NC=Not Covered by Sidoti & Company, LLC

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017E	2018E
Rev.(Mil.)	\$14.3	\$17.1	\$19.7	\$20.2	\$21.5	\$22.8	\$23.8	\$27.1	\$30.9	\$34.3
GAAP EPS	\$0.07	\$0.04	\$0.01	\$0.01	\$0.06	\$0.04	\$0.07	\$0.11	\$0.15	\$0.19

Description: OurPet's Company (www.ourpets.com) develops and markets products for improving the health, safety, comfort and enjoyment of cats, dogs and other pets. The company sells its products under two main brands: OurPet's and Pet Zone to specialty pet retailers, the mass market channel and e-commerce retailers. International sales accounted for 8% of 2016 sales. Headquarters are in Fairport Harbor, OH.

As we see it, OurPet's participates in an attractive, growing and recession-resistant industry. In 2015 (latest actual data supplied by American Pet Products Association (APPA)), the overall pet industry market in the U.S. grew 3.9% to \$60.28 billion, with about 85.8 million cats and 77.8 million dogs living in the U.S. We note that the U.S. pet industry also includes birds, fish, horses and other animals. Virtually all of OPCO's sales are related to cats and dogs. Since 1994, the pet industry has grown at a CAGR of 6.2%, even growing at an average annual rate of 5.2% per year during the financial crisis and recession in 2008 and 2009. Pet ownership is likely to continue to rise along with population growth and an improving economy. There has also been an ongoing trend of "humanizing" pets, with many pet owners treating their dogs and cats as part of their families. Too, we note that like humans, today's pets are also living longer, which further adds to the strength of the pet industry in our view. According to industry statistics, 36% of dogs are considered "seniors" (generally dogs more than 7 years old, depending on the breed) and 37% of cats are considered "seniors" (also typically more than 7 years old).

OurPet's focuses on innovation and product differentiation (most of the company's products are patented) and we expect OurPet's sales gains to outperform recent industry growth. OurPet's Company develops and now sells about 1,000 stock-keeping units (SKUs) to pet specialty retailers such as PetSmart and Petco (both private), ecommerce retailers such as amazon.com, (NASDAQ: AMZN, NC) and drsfostersmith.com (private) and mass market retailers like Wal-Mart (NYSE: WMT, NC), Kroger (NYSE: KR, NC) and Target (NYSE: TGT, NC). Virtually all of the company's products are manufactured by third parties in the U.S. and Asia. In 2017, OPCO will begin selling some products through As Seen on TV infomercials which will further expand the company's reach in our view. The company's products focus on three main categories: 1) interactive cat and dog toys and accessories, 2) feline waste and odor control solutions and 3) healthy feeding/ storage systems. Thanks to management's knowledge about animal behavior and nutrition, along with technical knowledge related to plastics, electronics and metal coatings, OPCO sells non-commoditized products that are innovative (i.e. Intelligent Pet Care™) and functional. Most of the company's products are patented. As such, after increasing its revenue by almost 14% in 2016, we think OurPet's can expand its annual revenue at an annual rate of about 12% over the next five years (through 2021), thanks to new product introductions, increasing sales to existing customers, sales to new customers and occasional price increases.

Factoring in a very scalable business model, we project the company's EPS will expand at a 5-year CAGR of 22%. About one third of all of the company's costs are fixed;

NR

Price Target: \$4

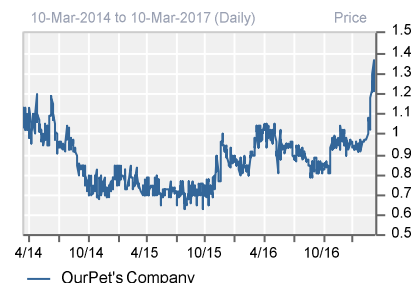
Price: \$1.21

Risk Rating: M

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Key Statistics

Analysts Covering	1
Market Cap (Mil)	\$20
Enterprise Value	\$27
52-Week Range (US OTC)	1-1
5-Year EPS CAGR	22%
Avg. Daily Trading Volume	11,000
Shares Out (Mil)	20.187
Float Shares (Mil)	7.477
Insider Ownership	63%
Institutional Holdings	Nil
Annualized Dividend	Nil
Dividend Yield	N/A
FCF Per Share (2018E)	\$0.06
FCF Yield (2018E)	5.0%
Net Cash Per Share (2018E)	(\$0.03)
Price to Book Value	2.3x
Return on Equity (2018E)	24.6%
Total Debt to Capital	21%
Interest Coverage Ratio	24.5x
Short Interest %	N/A
Short Interest Days To Cover	N/A
Russell 2000	1,365
Russell 2000 - Last 12 Months	32.0%
OPCO - Last 12 Months	34.4%



OurPet's Company

Source: FactSet Prices

the remaining two thirds are variable. By our model, the gross margin will expand 10 basis points in 2017 to 32.4% and another 20 basis points in 2018 to 32.6% mainly due to favorable fixed cost absorption. As we see it, OPCO will also be able to favorably leverage its operating expenses across a larger revenue base. Following an operating margin of 9.1% in 2015 and 9.9% in 2016, we anticipate the operating margin will expand another 140 basis points in 2017 to 11.3% and 80 basis points in 2018 to 12.1%. Assuming continued operating margin improvement, along with the aforementioned revenue gains and expected royalty income from *As Seen on TV*, we forecast EPS will reach \$0.29 by 2021, up from \$0.11 in 2016 (up 54% versus 2015) which implies a 5-year EPS CAGR of 22%.

We think the company's financials are in good shape with OPCO likely to generate positive free cash flow. OurPet's ended 2016 with cash of \$153,000 and total debt of almost \$3.0 million (21% of total capital). At the end of 2016 OPCO had \$2.1 million outstanding on its \$5 million revolving line of credit, a \$750,000 bank term note and roughly \$100,000 of other debt; too OurPet's was comfortably in compliance with its debt covenants. Free cash flow of \$1.5 million (\$0.08 per share) in 2016 reversed 2015's free cash outflow of \$792,000 (\$0.04 per share); improved profitability and better working capital management was just partly offset by higher capital expenditures. Our financial models assume marginal increases in capital spending in 2017 and 2018 and higher net income as well. On the other hand, we assume less favorable working capital changes. As such, we expect OurPet's to generate free cash flow of \$1.0 million (\$0.05 per share) in 2017 and \$1.2 million (\$0.06 per share) in 2018. Assuming no acquisitions (which could potentially materialize but are hard to predict given uncertainty about timing and size), we expect the company to pare debt to 12% of capital by the end of 2017 and to 5% of capital by year-end 2018.

We initiate coverage on shares of OurPet's Company (OPCO) with a \$4 price target. Since the founding the company in 1995, we think the management team of OurPet's Company has appropriately focused on developing functional, innovative and non-commoditized pet toys and accessories. Over the past three years, shares of OurPet's Company have traded in a range of 11x-24x *trailing* 12-month EPS, with an average multiple of 16x (as per FactSet). Considering the attractive pet industry dynamics, our expectation that OPCO's revenue will outperform the overall pet industry, expected operating margin expansion and the aforementioned free cash flow assumptions, we argue that shares of OurPet's Company should garner a higher valuation multiple. Our \$4 price target is based on 22x (in-line with our 5-year EPS growth rate projection of 22%) our 2018 EPS estimate of \$0.19.

Company And Management Overview

OurPet's management founded Napro, Inc. in 1985 as an enterprise for new ventures and acquisition of companies in different business lines. In 1995, Dr. Steven Tsengas (Chairman and CEO) and his son Konstantine (Dean) Tsengas (COO) got their first big break with the launch of the Big Dog Feeder® which was a hit in SkyMall magazine, catalogs and QVC (NASDAQ: QVCA, NC). This product is still sold by OPCO along with many other products. In 1996, Napro formed a wholly owned subsidiary called Virtu Company which began to market proprietary pet products under the OurPet's® label. In 1998, the company merged into Manticus, Inc. in exchange for 8 million shares of Manticus common stock. Ultimately Manticus changed its name to OurPet's Company. In 2001, the company became a publically traded entity on the OTC Bulletin Board.

Before founding OurPet's, Mr. Tsengas founded several high tech and consumer product companies which provided him with experience in electronics, polymers, metal finishing and veterinary sciences. We argue that this experience has effectively enabled OurPet's to develop innovative products with the goal of improving pets' health, safety, comfort and enjoyment. This included the 2001 launch of Play-N-Squeak® Mouse (for cats) and the 2004 introduction of Durapet® stainless steel bowls for example. While most of the company's growth has been on an organic basis, OurPet's has grown through acquisitions as well. In 2006, OurPet's acquired PetZone, a manufacturer and distributor of cat, dog and bird feeders, storage bins and other dog and cat products. In 2010 OPCO purchased Cosmic Catnip Products Company, a provider of catnip products, cat

toys, scratchers and toy treats. The last acquisition was in 2015, which was the purchase of seven bowl/feeder products, including the molds from Molor Products.

Aside from Messrs. Tsengas, OPCO's management team also includes Scott Mendes (CFO since 2009), Kathleen Homyock (VP, Sales and New Business Development since 2015, and with the company since 2013) and Gabriella Chessman (VP, Marketing since 2014 and with OPCO since 2012) who oversees roughly 50 employees. The company's 64,000 square foot headquarters building in Fairport Harbor, OH includes production, warehouse and office space. OurPet's also has a 26,000 square foot production, warehouse and office facility in Mentor, OH which is used for light manufacturing for the production of catnip and tuna consumable products. OPCO also rents space in two warehouses; 15,000 square feet in Warrensville Heights, OH for storage and fulfilling of orders to WMT and 25,000 square feet in Mentor, OH for storage of slow moving inventory. Even as we expect the company to continue to increase its sales, we do not expect any notable near-term additions to its management team or its properties. In our view, this will enable OurPet's to further expand its already healthy operating margins, which totaled 9.9% in 2016.

Marketing and sales activities are conducted through 14 employees and 20 independent sales representatives. The latter group is paid on commissions, which range from 3% to 15% of net sales to customers. Larger (and usually national) retailers typically order directly from OPCO while smaller retailers usually obtain products from distributors.

The Pet Industry Is Growing

According to the 2015-2016 APPA National Pet Owners Survey, 65% of U.S. households, or 79.7 million homes, own a pet (up from 56% in 1988). In step with this rising trend, APPA puts estimated household spending on pets at \$62.75 billion for 2016 (a 6.1% CAGR relative to \$17 billion in 1994); which has grown every year, even during the financial crisis and recession in 2008 and 2009. Roughly 19% of this spending was for pet accessories and treats. Packaged Facts (a consumer market research firm) and APPA predict that total U.S. sales for the pet industry will increase at a CAGR of 4%-5% through 2020, based on expectations for continued pet ownership growth and increased longevity for pet dogs and cats. Annual spending for other than food averages \$1,049 for dogs and \$846 for cats.

In the U.S., there are about 8,300 independent pet shops and two national pet specialty retailers: PetSmart and Petco Animal Supplies (both are among OPCO's top customers) which have around 1,500 stores each. The pet specialty channel accounts for about 41% of the company's sales, with revenue to this channel up 8% in 2016. In addition, mass market retailers such as WMT, KR, TGT and Publix (private) also sell pet supplies. Sales to food, drug and mass retailers account for 43% of OPCO's revenue and increased 14% in 2016. In fact, WMT is OPCO's largest customer, accounting for around 26% of total net sales. There are also numerous e-commerce retailers that sell pet supplies, such as e-commerce giant amazon.com, its subsidiary wag.com, along with privately-held drsfostersmith.com, bigbreddog.com, entirelypets.com, and thecatconnection.com, for example. Sales to e-commerce retailers account for 10% of sales (up 3% in 2016), with about 6% of the company's revenue coming from other distribution channels. In addition, in order to accelerate sales to the e-commerce channel, the company recently promoted someone internally to a position that solely focuses on increasing sales to e-commerce retailers.

Key competitors of OPCO include Worldwide, Inc., The Kong Company, Pet Stages, Inc., The Hartz Mountain Corporation, PetSafe (part of Radio Systems Corporation) and Rolf C. Hagen, Inc. All of these companies are privately held.

Two Main Brands Focus On Cats And Dogs

In 2016, about 61% of sales were related to products for cats, 38% for dogs and 1% for other pets, mostly birds. OPCO focuses on three main product segments: toys and accessories (53% of sales in 2016), feeding/storage solutions (34%) and waste management products (4%). The other 9% of revenue is related to sales of edibles/consumables, doghouses and other products, which are less of a priority for management. According to Packaged Facts, the total annual addressable market for interactive cat and dog toys accessories, feline waste and odor control solutions and healthy feeding/storage systems is \$1 billion, \$250 million and \$100 million, respectively. In 2012, the company began work on

implementing a new branding strategy with two brands: OurPet's and PetZone. OurPet's is the premium brand aimed at pet "parents" and is specific to the pet specialty retailing market, which includes PetSmart, Petco and other pet retailers and distributors. PetZone is intended for the food, drug and mass retail channels, like Walmart and Kroger and is aimed at pet "enthusiasts". Both brands are sold to e-commerce retailers. The company completed this transition in late 2015. OPCO also has a private-label business (around 16% of total revenue) with some pet specialty retailers, which helps the company to maintain the appropriate amount of shelf space.

Toys and accessories largely center around products for cats as the market for dog toys and accessories is more competitive and more commoditized. Cat toys include mice with Realmouse® sounds, mice with rattle sounds, refillable (with catnip) toys, cat scratchers, treat dispensers and interactive electronic toys such as Whirling Wiggler Spinner™, Catty Whack™, Pounce House™ and Bird in a Cage™. Dog toys mainly consist of treat dispensers and toss toys.

The feeding/storage systems segment includes products such as the Big Dog Feeder, Store-N-Feed® Single Adjustable Feeder and Wonderbowl® Selective Feeder as well as numerous cat and dog bowls that come in various sizes, shapes, designs and colors. Within this segment, one of the recent products is the MetalShield™ collection of bowls which has a durable, chip resistant coating of metals (i.e. chrome) on special plastic. Unlike pure plastic bowls, these bowls do not release toxic substances when exposed to food but like plastic bowls, MetalShield™ is dishwasher-safe.

For cats, waste management products include litter boxes and accessories (i.e. odor control litter box spray, waste bags) while for dogs, waste management products mostly consist of pooper scoopers and pick-up bags. OPCO's management views the pet waste management market (\$3.5 billion annually in total comprised of \$2.5 billion tied to sales of cat litter and another \$1 billion to litter bags and scoopers) as a currently underpenetrated area with attractive growth opportunities particularly with its new biodegradable cat litter, further discussed below.

New Products Continue Focus On Innovation

In 2016, 10% of OPCO's revenue came from new products. Last year, the company introduced its Intelligent Pet Care™ line of Bluetooth® enabled products which work with the OPCO's SmartLink™ Waterer (water fountain which filters impurities, maintains ideal water temperature, sends alerts when water level is low, etc.), SmartLink™ Feeder (a pet bowl which only opens when the cat or dog wearing a SmartLink™ tag comes close to the bowl) and SmartScoop® Intelligent Litter Box (which automatically scoops up waste). All of these products were the first ones on the market to connect pets and pet owners with technology by providing real-time updates regarding drinking, feeding and waste elimination habits of their pets via smartphones.

Last year, OPCO also rolled out its new Switchgrass Natural Cat Litter with BioChar (biodegradable activated carbon). This has enabled the company to effectively enter the \$250 million annual market for natural cat litter. This cat litter is biodegradable and unlike non-biodegradable litters, will not harm cats if eaten or inhaled. This product also has the more common high water and odor absorption with strong clumping action.

OPCO is also developing, with Israel-based Paulee Cleantec Ltd., a safe chemical process (exothermic oxidation) that converts animal waste into an effective, odor-free fertilizer in about a minute. We suspect this item will be available for sale by late 2017 or early 2018.

Product Development And Sourcing

Before an item is brought to market, OPCO's staff carefully evaluates product ideas through behavioral and technology research of pets and pet owners. When appropriate, the company also uses consumer focus groups to evaluate new products. The goal is to develop products that are functional, innovative and not easily commoditized. After going through a lengthy (and expensive) litigation process regarding Smart Scoop® in 2007-2012, management developed a rigorous patent process with 75% of sales now covered by patents. The company now has 170 patents that are issued or pending. Once products are tested, the company's sourcing team uses various outside resources to manufacture the products, in the U.S. (around 40% of sales) and outside of the U.S. (other 60%) mainly Canada, India and China. The company's supply chain offers its customers warehouse services, drop-ship programs, FOB (free on board) China and India (meaning the sale of products occurs at the shipping point) and program fulfillment (as per the customers' needs). Too, the company's upgraded IT capabilities include EDI (Electronic Data Interchange), TWL (Total Warehouse Logistics) and real-time inventory reporting which enables OurPet's to quickly and efficiently respond to customer needs and requests.

Expect As Seen on TV To Be A Further Catalyst

In spring 2017, the company will begin to sell certain products such as its Bird in a Cage™, Whirling Wiggler™ spinner toy and Mouse in a Pouch™ via 30 and 60 second infomercials. The actual product names sold via infomercials will be different, but otherwise will be exactly the same items as those sold through the company's main sales channels. OurPet's will receive royalty income from sales tied to the *As Seen on TV* infomercials. Too, the company that will air the infomercials on TV will take on all the inventory risk, which we view favorably for OPCO. In addition, some mass market retailers will also carry these products, which will be placed in the same section as other *As Seen on TV* products. This royalty income will be booked as other income on the company's income statement. We estimate about \$600,000 of other income attributable to *As Seen on TV* in 2017 and nearly \$1.1 million in 2018.

Recent Results And Company Outlook

On February 27th the company reported that 4Q:16 revenue jumped 23.3% to \$8.2 million. By segment, pet specialty channel sales surged 30%, sales to the food, drug and mass channel rose 17%, while sales to e-commerce retailers slipped 4%. Gross margin was up 340 basis points to 35.4% mainly due to improved absorption of fixed costs during the company's seasonally strongest revenue quarter. With SG&A expenses declining to 20.2% of sales versus 21.0% in 4Q:15, the operating margin jumped 420 basis points to 15.2%. With a tax rate only 2.9% (versus 36.0% in 4Q:15), December-quarter EPS tripled to \$0.06.

While management does not provide any sales or EPS guidance, OPCO noted in its earnings release that "as we continue to innovate, build retailer relationships and deliver great products to our customers, we will continue to set records in 2017 and beyond".

Financial Review And Outlook

Expect revenue gains to further improve

In 2015, total revenue rose 4.6% to \$23.8 million on both price and unit volume increases. In 2015, sales remained about flat in the food, drug and mass retail channel while sales increased 12% in the pet specialty channel and 6% in the e-commerce channel. In 2016, total sales were up 13.6% to \$27.1 million. We attribute these gains mostly to 14% growth in the food, drug and mass retail channel, 8% sales expansion in the pet specialty channel and 3% top-line growth in the e-commerce channel.

In our view, total revenue will increase 14.3% in 2017 to \$30.9 million and 10.8% in 2018 to \$34.3 million due to continued growth in the food, drug and mass channel, further improvement in the pet specialty channel and accelerated growth via the e-commerce sales channel. We highlight OPCO's increased emphasis on e-commerce. We think this focus makes strategic sense, given our expectation that overall e-commerce sales growth will outpace sales growth at brick-and-mortar retailers. By 2021, we estimate total revenue will expand to \$46.9 million which equates to a CAGR of about 12%, using 2016 as the base year. Our estimates do not include acquisitions, given the uncertainty about timing and size of potential transactions. Management has indicated that any potential acquisition would need to make strategic sense, must be accretive to net income and be large enough to move the needle.

Expect additional operating margin expansion

Following the 380-basis point expansion in the operating margin in 2015 to 9.1%, the operating margin increased another 80 basis points to 9.9% in 2016 as the gross margin expanded 60 basis points to 32.3% and SG&A expenses decreased to 22.4% of sales (from 22.6% of sales in 2015). As we see it, the company will be able to further enhance its gross margin by 10 basis points in 2017 and 20 basis points in 2018 mostly thanks to anticipated leverage of fixed costs (i.e. personnel,

warehouse space). About 63% of SG&A expenses are fixed. Thus, as revenue expands, we expect SG&A expenses to decline as a percentage of sales. As such, we estimate operating margin expansion to 11.3% in 2017 and to 12.1% in 2018. By 2021, we anticipate operating margin expansion to 14.5%.

Expect EPS Growth At A CAGR Of 22% Through 2021

After increasing EPS by 64% to \$0.07 in 2015, EPS increased another 54% in 2016 to \$0.11. Aside from the aforementioned revenue and operating margin expansion, the company's bottom line also benefited from a lower tax rate which totaled 19.8% in 2016 versus 36.0% in 2015. In 2016, the company completed a tax planning process (including setting up a captive insurance subsidiary) which will reduce OPCO's effective tax rate to 20%-25% going forward. Our financial models assume a 25% tax rate.

Given our previously articulated expectation for ongoing revenue gains, operating margin expansion, increased other income (from royalty income tied to *As Seen on TV*), we expect EPS to rise 44% in 2017 to \$0.15 and 26% in 2018 to \$0.19. By 2021, we estimate EPS of \$0.29 which implies a 5-year CAGR of 22%.

Expect positive free cash flow

In 2015, OurPet's posted a free cash outflow of \$792,000 or \$0.04 per share. However, thanks to improved profitability and better working capital management, partly offset by higher cap-ex, free cash flow in 2016 was positive \$1.5 million or \$0.08 per share. We assume marginal increases of cap-ex in 2017 and 2018 (to \$739,000 and \$747,000 respectively from \$738,000 in 2016) together with increased profitability and higher net income. With less favorable working capital changes, we project that OPCO will produce free cash flow of \$1.0 million (\$0.05 per share) in 2017 and \$1.2 million (\$0.06 per share) in 2018.

Expect the balance sheet to further improve

After ending 2015 with cash of \$100,000 and total debt of \$4.4 million (34% debt to total capital ratio), OurPet's ended 2016 with cash of \$153,000 and total debt of \$3.0 million (21% of total capital). In 2016 inventory turns (calculated as COGS/average inventories) were 2.5x versus 2.2x in 2015. We project inventory turns of 2.7x in 2017 and 2.5x in 2018. Given the aforementioned expectations regarding free cash flow generation, we project OPCO will end 2017 with total debt at 12% of total capital and estimate 2018 year-end debt of only 5% of total capital.

The company's \$5 million line of credit (of which \$2.9 million was available at the end of 2016) is valid until June 2018 and carries an interest rate of 30-day LIBOR plus 2.25%. This line of credit has two main covenants: a debt service coverage ratio of at least 1 to 1.15 and minimum tangible net worth of \$6 million. OPCO ended 2016 with a debt service coverage ratio of 2.67 and tangible net worth of \$9.9 million. Aside from the

revolver, OurPet's had a bank term note of \$750,000 outstanding at year-end 2016 with an interest rate of 30-day LIBOR plus 3% (due 2020), and other miscellaneous debt totaling roughly \$100,000 at the end of 2016.

In 2010, the company sold 123,616 shares of its Series 2009 Preferred Stock in a private placement at \$7 per share. All preferred shares receive a 6% cash dividend payable each December 1st, which equates to an aggregate payment of \$51,919 every fourth quarter. If the common stock were to trade for 20 consecutive days above \$1.50 per share, OPCO has the right to convert preferred shares into common shares.

Risks

If OurPet's was unable to obtain or protect its **patents** this would exacerbate competition. The company competes against many (and often much larger) companies in the pet supplies market. We attribute much of OPCO's success due to its ability to develop innovative and differentiated products that are protected by patents.

The management team of OurPet's Company owns about 63% of the outstanding shares (with Dr. Steve Tsengas, CEO, owning approximately 31% of OPCO shares). With a **limited float** (only about 37% of the shares are available to outside investors), we view the relatively limited ability to buy or sell OPCO shares as a potential risk.

While the pet industry has exhibited recession-resistant performance, we think **the economy** is the most significant external risk for OPCO. A rise in unemployment and/or sluggish income growth would likely dampen consumer confidence and decelerate spending on pet supplies.

Valuation

As we see it, OurPet's Company is well-positioned to benefit from the favorable backdrop of a healthy and growing pet industry and the increasing humanization of pets. We think the management team of OurPet's Company has appropriately focused on developing innovative, functional and non-commoditized products mostly for cats and dogs. After 2016's sales increase of 14% and EPS improvement of 54%, we anticipate further revenue and EPS growth in 2017 and over the next five years, we predict revenue and EPS to expand at a CAGR of 12% and 22% respectively.

Over the past three years, shares of OurPet's Company have traded in a range of \$0.63 in July 2015 to a recent high of \$1.32. On a valuation basis, OPCO shares have traded in a range of 11x-24x *trailing* 12-month EPS, with an average multiple of 16x (as per FactSet). Given the attractive pet industry dynamics and our prediction that OPCO's revenue will outperform the overall pet industry, expected operating margin expansion, increased brand exposure through upcoming *As Seen On TV* infomercials and the aforementioned free cash flow generation, we argue that shares of OurPet's Company ought to trade at a higher valuation multiple and in-line with our expected 5-year EPS growth rate projection of 22%. Our \$4 price target is thus based on 22x our 2018 EPS estimate of \$0.19.

OURPET'S COMPANY

Table 1: OurPet's Company Income Statement

	2014	2015	Mar.	June	Sept.	Dec.	2016	Mar. E	June E	Sept. E	Dec. E	2017 E	Mar. E	June E	Sept. E	Dec. E	2018 E
Net revenue	\$ 22,770,562	\$ 23,819,189	\$ 6,175,985	\$ 5,436,902	\$ 7,259,904	\$ 8,197,370	\$ 27,070,161	\$ 7,411,182	\$ 6,524,282	\$ 8,058,493	\$ 8,935,133	\$ 30,929,091	\$ 8,152,300	\$ 7,176,711	\$ 8,944,928	\$ 10,007,349	\$ 34,281,288
Cost of goods sold	15,959,603	16,269,676	4,344,128	3,865,058	4,816,434	5,291,941	18,317,561	5,205,542	4,625,021	5,330,125	5,750,345	20,911,034	5,713,868	5,078,911	5,898,549	6,410,365	23,101,693
Gross profit	6,810,959	7,549,513	1,831,857	1,571,844	2,443,470	2,905,429	8,752,600	2,205,640	1,899,261	2,728,369	3,184,788	10,018,058	2,438,432	2,097,800	3,046,379	3,596,984	11,179,595
SG&A expenses	5,608,934	5,389,897	1,416,588	1,344,142	1,649,506	1,658,909	6,069,145	1,571,839	1,491,453	1,778,992	1,674,178	6,516,463	1,691,308	1,604,812	1,919,604	1,816,193	7,031,918
Operating income	1,202,025	2,159,616	415,269	227,702	793,964	1,246,520	2,683,455	633,801	407,808	949,376	1,510,610	3,501,595	747,124	492,987	1,126,775	1,780,791	4,147,677
Other (income) and expense, net	(67,028)	(43,623)	(27,006)	(7,463)	(24,125)	(43,193)	(101,787)	(33,758)	(135,000)	(245,000)	(325,000)	(738,758)	(265,000)	(229,500)	(281,750)	(383,500)	(1,159,750)
Interest expense	126,771	115,735	32,835	27,920	23,450	25,386	109,591	28,102	27,436	22,027	21,858	99,424	22,003	20,403	13,438	11,159	67,004
Pretax income	1,142,282	2,087,504	409,440	207,245	794,639	1,264,327	2,675,651	639,456	515,372	1,172,349	1,813,752	4,140,929	990,121	702,084	1,395,086	2,153,132	5,240,423
Income tax expense	373,007	750,592	142,859	52,611	298,972	36,616	531,058	159,864	128,843	293,087	453,438	1,035,232	247,530	175,521	348,772	538,283	1,310,106
Net income	769,275	1,336,912	266,581	154,634	495,667	1,227,711	2,144,593	479,592	386,529	879,262	1,360,314	3,105,696	742,591	526,563	1,046,315	1,614,849	3,930,317
Diluted EPS	\$ 0.04	\$ 0.07	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.06	\$ 0.11	\$ 0.02	\$ 0.02	\$ 0.04	\$ 0.07	\$ 0.15	\$ 0.04	\$ 0.03	\$ 0.05	\$ 0.08	\$ 0.19
Weighted average diluted share count	18,159,204	19,262,742	19,458,841	18,277,335	20,090,366	20,187,339	20,134,777	20,268,088	20,295,855	20,349,161	20,366,891	20,320,199	20,430,233	20,437,926	20,532,303	20,529,826	20,482,772

Margin analysis

Gross margin	29.9%	31.7%	29.7%	28.9%	33.7%	35.4%	32.3%	29.8%	29.1%	33.9%	35.6%	32.4%	29.9%	29.2%	34.1%	35.9%	32.6%
SG&A expenses as a % of sales	24.6%	22.6%	22.9%	24.7%	22.7%	20.2%	22.4%	21.2%	22.9%	22.1%	18.7%	21.1%	20.7%	22.4%	21.5%	18.1%	20.5%
Operating margin	5.3%	9.1%	6.7%	4.2%	10.9%	15.2%	9.9%	8.6%	6.3%	11.8%	16.9%	11.3%	9.2%	6.9%	12.6%	17.8%	12.1%
Pretax margin	5.0%	8.8%	6.6%	3.8%	10.9%	15.4%	9.9%	8.6%	7.9%	14.5%	20.3%	13.4%	12.1%	9.8%	15.6%	21.5%	15.3%
Effective tax rate	32.7%	36.0%	34.9%	25.4%	37.6%	2.9%	19.8%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
Net margin	3.4%	5.6%	4.3%	2.8%	6.8%	15.0%	7.9%	6.5%	5.9%	10.9%	15.2%	10.0%	9.1%	7.3%	11.7%	16.1%	11.5%

Year-over-year % change

Net sales	5.6%	4.6%	10.3%	-2.7%	21.3%	23.3%	13.6%	20.0%	20.0%	11.0%	9.0%	14.3%	10.0%	10.0%	11.0%	12.0%	10.8%
Gross profit	2.0%	10.8%	8.1%	-8.5%	21.4%	36.7%	15.9%	20.4%	20.8%	11.7%	9.6%	14.5%	10.6%	10.5%	11.7%	12.9%	11.6%
SG&A expenses	13.1%	-3.9%	5.9%	3.7%	21.0%	19.1%	12.6%	11.0%	11.0%	7.9%	0.9%	7.4%	7.6%	7.6%	7.9%	8.5%	7.9%
Operating income	-30.0%	79.7%	16.5%	-46.1%	22.3%	70.3%	24.3%	52.6%	79.1%	19.6%	21.2%	30.5%	17.9%	20.9%	18.7%	17.9%	18.5%
Pretax income	-34.0%	82.7%	21.7%	-50.5%	26.6%	79.5%	28.2%	56.2%	148.7%	47.5%	43.5%	54.8%	54.8%	36.2%	19.0%	18.7%	26.6%
Net income (loss)	-28.2%	73.8%	24.7%	-41.0%	20.8%	172.5%	60.4%	79.9%	150.0%	77.4%	10.8%	44.8%	54.8%	36.2%	19.0%	18.7%	26.6%
Diluted EPS	-27.8%	63.8%	27.3%	-38.0%	19.2%	161.5%	53.5%	72.7%	125.1%	75.1%	9.8%	43.5%	53.6%	35.3%	17.9%	17.8%	25.5%

Sources: Company reports and Sidoti & Company, LLC estimates

OURPET'S COMPANY

Table 2: OurPet's Company Statement of Cash Flows

	2014	Mar.	June	Sept.	Dec.	2015	Mar. A	June A	Sept. A	2016 E	2017 E	2018 E
Net income	\$ 769,275	\$ 213,792	\$ 262,076	\$ 410,451	\$ 450,593	\$ 1,336,912	\$ 266,581	\$ 154,633	\$ 495,668	\$ 2,144,593	\$ 3,105,696	\$ 3,930,317
Adjustments:												
Loss on Fixed Assets Written Off	52,633	6,638	-	14,018	4,501	25,157	9,474	-	1,379	11,343	-	-
Depreciation expense	571,587	151,880	161,966	143,135	162,666	619,647	158,685	166,590	126,136	598,911	601,906	604,313
Amortization expense	79,353	20,094	20,278	18,956	17,013	76,341	12,508	13,193	14,038	52,959	55,077	57,831
Stock option and warrant expense	33,809	6,000	6,000	6,000	(3,789)	14,211	6,000	6,000	6,000	12,000	12,600	13,230
Accounts receivable - trade	(305,309)	254,152	(644,734)	(541,729)	(246,051)	(1,178,362)	366,082	603,725	(1,236,141)	(346,988)	(647,870)	(1,004,120)
Inventories	(1,017,391)	(21,520)	(1,131,735)	244,695	(111,938)	(1,020,498)	473,260	260,137	(565,427)	904,077	(1,239,670)	(1,671,458)
Prepaid expenses and other	(81,325)	(100,686)	108,446	3,707	(115,550)	(104,083)	(181,132)	118,732	(144,386)	(374,564)	(92,979)	(90,728)
Amortizable Intangible Asset Additions	(92,566)	(12,890)	(10,050)	(13,584)	(13,095)	(49,619)	(17,820)	(26,332)	(30,103)	(99,891)	(75,500)	(66,000)
Accounts payable - trade	320,057	205,240	190,425	(640,762)	337,964	92,867	(634,235)	(232,492)	843,061	(797,949)	42,877	68,053
Accrued expenses	(295,519)	(39,505)	95,621	35,045	(84,794)	6,367	(85,768)	45,110	281,877	141,673	(61,333)	70,687
Deferred tax liabilities	35,876	(18,921)	(35,803)	(21,980)	128,887	52,183	(18,631)	5,752	16,812	28,919	83,770	33,798
Net cash provided by (used in) operating activities	70,480	664,274	(977,510)	(342,048)	526,407	(128,877)	355,004	1,115,048	(191,086)	2,275,083	1,784,575	1,945,925
Acquisition of property and equipment, net	(502,559)	(178,405)	(242,123)	(69,813)	(173,175)	(663,516)	(224,485)	(199,494)	(163,967)	(737,900)	(739,376)	(746,770)
Net cash used in investing activities	(502,559)	(178,405)	(242,123)	(69,813)	(173,175)	(663,516)	(224,485)	(199,494)	(163,967)	(737,900)	(739,376)	(746,770)
Principal payments on long-term debt	(497,552)	(62,513)	(62,771)	(430,764)	(97,226)	(653,274)	(72,490)	(72,701)	(71,290)	(278,994)	(81,504)	(182,007)
Principal borrowings of long-term debt	-	-	-	1,000,000	-	1,000,000	-	-	-	-	-	-
Net borrowing (payment) on bank line of credit	1,029,000	(526,000)	1,231,000	(94,000)	(205,862)	405,138	(87,138)	(775,000)	359,934	(1,183,204)	(940,140)	(785,050)
Issuances of stock	87,023	-	-	-	-	-	7,000	22,891	-	29,913	32,067	33,670
Dividends paid on Preferred Stock	(51,919)	-	-	-	(51,919)	(51,919)	-	-	-	(51,919)	(51,919)	(51,919)
Net cash provided by financing activities	566,552	(588,513)	1,168,229	475,236	(355,007)	699,945	(152,628)	(824,810)	288,644	(1,484,204)	(1,041,496)	(985,306)
Net increase (decrease) in cash	134,473	(102,644)	(51,404)	63,375	(1,775)	(92,448)	(22,109)	90,744	(66,409)	52,979	3,703	213,849
Cash at beginning of period	57,975	192,448	89,804	38,400	101,775	192,448	100,000	77,891	168,635	100,000	152,979	156,682
Cash at end of period	\$ 192,448	\$ 89,804	\$ 38,400	\$ 101,775	\$ 100,000	\$ 100,000	\$ 77,891	\$ 168,635	\$ 102,226	\$ 152,979	\$ 156,682	\$ 370,531
Operating cash flow /share	\$ 0.00	\$ 0.03	\$ (0.05)	\$ (0.02)	\$ 0.03	\$ (0.01)	\$ 0.02	\$ 0.06	\$ (0.01)	\$ 0.11	\$ 0.09	\$ 0.10
Free cash flow (op. cf - cap ex.)	(432,079)	485,869	(1,219,633)	(411,861)	353,232	(792,393)	130,519	915,554	(355,053)	1,537,183	1,045,199	1,199,155
Free cash flow/ share	\$ (0.02)	\$ 0.02	\$ (0.06)	\$ (0.02)	\$ 0.02	\$ (0.04)	\$ 0.01	\$ 0.05	\$ (0.02)	\$ 0.08	\$ 0.05	\$ 0.06

Sources: Company reports and Sidoti & Company, LLC estimates

OURPET'S COMPANY

Table 3: OurPet's Company Balance Sheet

	2014	Mar.	June	Sept.	2015	Mar.	June	Sept.	2016	2017 E	2018 E
Cash and cash equivalents	\$ 192,448	\$ 89,804	\$ 38,400	\$ 101,775	\$ 100,000	\$ 77,891	\$ 168,635	\$ 102,226	\$ 152,979	\$ 156,682	\$ 370,531
Accounts receivable, net	3,116,448	2,862,296	3,507,030	4,048,759	4,294,810	3,928,728	3,325,003	4,561,144	4,641,798	5,289,668	6,293,788
Inventory, net	6,894,115	6,915,635	8,047,370	7,802,675	7,914,613	7,441,353	7,181,216	7,746,643	7,010,536	8,250,206	9,921,663
Prepaid expenses and other	478,593	579,279	470,833	467,126	582,676	763,808	645,076	738,487	885,391	972,865	1,053,094
Total current assets	10,681,604	10,447,014	12,063,633	12,420,335	12,892,099	12,211,780	11,319,930	13,148,500	12,690,704	14,669,420	17,639,075
Net property and equipment	1,769,548	1,789,433	1,954,591	1,867,252	1,873,260	1,929,585	1,962,490	1,998,942	2,000,906	2,138,376	2,280,833
Amortizable Intangible Assets	384,063	376,861	366,632	361,259	357,341	362,654	375,792	391,857	404,273	424,696	432,864
Intangible Assets	461,000	461,000	461,000	461,000	461,000	461,000	461,000	477,328	477,328	477,328	477,328
Goodwill	67,511	67,511	67,511	67,511	67,511	67,511	67,511	67,511	67,511	67,511	67,511
Deposits and other assets	18,003	18,003	18,003	18,003	18,003	18,003	18,003	52,650	73,524	79,029	89,529
Total other assets	930,577	923,375	913,146	907,773	903,855	909,168	922,306	989,346	1,022,636	1,048,564	1,067,232
Total assets	13,381,729	13,159,822	14,931,370	15,195,360	15,669,214	15,050,533	14,204,726	16,136,788	15,714,246	17,856,360	20,987,141
Current maturities of long-term debt	601,632	561,017	520,420	311,470	276,890	263,128	248,153	234,146	228,941	222,441	215,940
Accounts payable - trade	1,489,982	1,695,222	1,885,647	1,244,885	1,582,849	948,614	716,122	1,559,183	784,900	827,777	895,831
Other accrued expenses	565,491	525,986	621,607	656,652	571,858	486,090	531,200	813,077	713,531	652,198	722,885
Total current liabilities	2,657,105	2,782,225	3,027,674	2,213,007	2,431,597	1,697,832	1,495,475	2,606,406	1,727,372	1,702,416	1,834,656
Long-term debt - less current portion	119,780	97,882	160,708	938,894	876,248	817,520	759,794	702,511	645,203	570,199	394,693
Revolving Line of Credit	2,862,032	2,336,032	3,567,032	3,473,032	3,267,170	3,180,032	2,405,032	2,764,966	2,083,966	1,143,826	358,776
Deferred Income Taxes	281,651	262,730	226,927	204,947	333,834	315,203	320,955	337,767	362,753	446,523	480,321
Total long term liabilities	3,263,463	2,696,644	3,954,667	4,616,873	4,477,252	4,312,755	3,485,781	3,805,244	3,091,922	2,160,548	1,233,790
Total liabilities	5,920,568	5,478,869	6,982,341	6,829,880	6,908,849	6,010,587	4,981,256	6,411,650	4,819,294	3,862,964	3,068,446
Total stockholders' equity	7,461,161	7,680,953	7,949,029	8,365,480	8,760,365	9,039,946	9,223,470	9,725,138	10,894,952	13,993,396	17,918,695
Total liabilities and stockholders' equity	13,381,729	13,159,822	14,931,370	15,195,360	15,669,214	15,050,533	14,204,726	16,136,788	15,714,246	17,856,360	20,987,141
Return on average equity	10.9%	11.8%	13.0%	16.8%	9.5%	16.6%	14.9%	15.1%	21.8%	25.0%	24.6%
Return on average assets	6.1%	6.5%	6.7%	8.8%	5.3%	9.9%	8.8%	8.7%	13.7%	18.5%	20.2%
Return on invested capital	7.0%	7.9%	7.9%	9.9%	5.8%	10.4%	10.1%	10.2%	15.5%	19.5%	20.8%
Book value per share (fully diluted)	\$ 0.41	\$ 0.39	\$ 0.41	\$ 0.42	\$ 0.45	\$ 0.46	\$ 0.50	\$ 0.48	\$ 0.54	\$ 0.69	\$ 0.87
Net cash (debt) per share	\$ (0.19)	\$ (0.15)	\$ (0.22)	\$ (0.23)	\$ (0.22)	\$ (0.21)	\$ (0.18)	\$ (0.18)	\$ (0.14)	\$ (0.09)	\$ (0.03)
Current ratio	4.0	3.8	4.0	5.6	5.3	7.2	7.6	5.0	7.3	8.6	9.6
Total debt to total capital	32.4%	28.1%	34.8%	36.1%	33.5%	32.0%	27.0%	27.6%	21.4%	12.2%	5.1%
Inventory turnover (COGS/ avg. inventories)	2.5	2.3	2.1	2.1	2.2	2.3	2.2	2.3	2.5	2.7	2.5

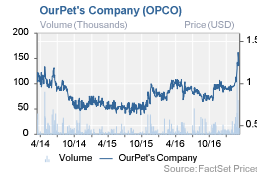
Sources: Company reports and Sidoti & Company, LLC estimates

Appendix

Required Disclosures

Required Disclosures

OurPet's Company (OPCO-\$1.21) NR Price Target: \$4 Risk Rating: M



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Appendix

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