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PETMED EXPRESS INC
Form 10QSB
February 10, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

Form 10-QSB

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended December 31, 2002

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934.

For the transition period from _____ to _____

Commission file number: 000-28827

PETMED EXPRESS, INC.

(Exact Name of Small Business Issuer as Specified in its Charter)

FLORIDA

65-0680967

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer Identification No.)

1441 S.W. 29th Avenue, Pompano Beach, Florida 33069

(Address of Principal Executive Offices)

(954) 979-5995

(Issuer's Telephone Number, Including Area Code)

APPLICABLE ONLY TO ISSUERS INVOLVED IN
BANKRUPTCY PROCEEDINGS DURING THE
PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports
required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the
distribution of securities under a plan confirmed by a court:

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's
classes of common equity, as of the latest practicable date: 17,658,010
Common Shares, \$.001 par value per share

Transitional Small Business Disclosure Form (check one):

Yes No

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This discussion in this quarterly report regarding PetMed Express and our business and operations contains "forward-looking statements." These forward-looking statements use words such as "believes," "intends," "expects," "may," "will," "should," "plan," "projected," "contemplates," "anticipates," or similar statements. These statements are based on our beliefs, as well as assumptions we have used based upon information currently available to us. Because these statements reflect our current views concerning future events, these statements involve risks, uncertainties and assumptions. Actual future results may differ significantly from the results discussed in the forward-looking statements. A reader, whether investing in our common stock or not, should not place undue reliance on these forward-looking statements, which apply only as of the date of this quarterly report.

When used in this quarterly report on Form 10-QSB, "PetMed Express," "PetMed Express.com," "PetMed," "1-800-PetMeds," "1-888-PetMeds," "the Company," "we," "our," and "us" refers to PetMed Express, Inc. and our subsidiaries.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

PETMED EXPRESS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
(UNAUDITED)

	December 31, 2002

ASSETS	

Current assets:	
Cash and cash equivalents	\$ 131,273
Accounts receivable, less allowance for doubtful accounts of \$10,263	411,346
Inventories	6,643,721
Prepaid expenses and other current assets	190,915

Total current assets	7,377,255
Property and equipment, net	1,520,589
Intangible asset	365,000
Other assets, net	200,155

Total assets	\$ 9,462,999
	=====
 LIABILITIES AND SHAREHOLDERS' EQUITY	

Current liabilities:	
Accounts payable and accrued expenses	\$ 4,712,055

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Line of credit	1,000,000
Current portion of loan obligation	68,442

Total current liabilities	5,780,497
Loan obligation, less current portion	85,553

Total liabilities	5,866,050

Commitments and contingencies	
Shareholders' equity:	
Preferred stock, \$.001 par value, 5,000,000 shares authorized; 2,500 convertible shares issued and outstanding with a liquidation preference of \$4 per share	8,898
Common stock, \$.001 par value, 40,000,000 shares authorized; 17,658,010 shares issued and outstanding	17,658
Additional paid-in capital	6,999,910
Accumulated deficit	(3,429,517)

Total shareholders' equity	3,596,949

Total liabilities and shareholders' equity	\$ 9,462,999
	=====

See accompanying notes to condensed consolidated financial statements

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PETMED EXPRESS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended December 31,		Nine Months December
	2002	2001	2002
	-----	-----	-----
Sales	\$ 11,050,124	\$ 8,248,901	\$ 40,110,581
Cost of sales	6,341,577	4,666,066	22,939,240
	-----	-----	-----
Gross profit	4,708,547	3,582,835	17,171,341
	-----	-----	-----
Operating expenses:			
General and administrative	1,801,081	1,589,912	5,858,693
Advertising	2,116,258	1,549,154	8,755,679

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Severance charges	-	-	-
Depreciation and amortization	97,939	75,336	264,711
Total operating expenses	4,015,278	3,214,402	14,879,083
Income (loss) from operations	693,269	368,433	2,292,258
Other income (expense):			
Adjustment of estimate for legal settlement	-	-	-
Gain (loss) on disposal of property and equipment	15,000	109	15,000
Interest expense	(8,876)	(4,333)	(18,916)
Interest income	505	2,734	6,462
Other, net	1,247	(13,595)	4,534
Total other income (expense)	7,876	(15,085)	7,080
Income (loss) before provision for income taxes	701,145	353,348	2,299,338
Provision for income taxes	266,435	-	757,412
Net income (loss)	\$ 434,710	\$ 353,348	\$ 1,541,926
Net income (loss) per common share:			
Basic	\$ 0.03	\$ 0.02	\$ 0.09
Diluted	\$ 0.02	\$ 0.02	\$ 0.07
Weighted average number of common shares outstanding:			
Basic	17,658,010	16,360,010	17,142,763
Diluted	21,662,154	18,263,436	20,999,411

See accompanying notes to condensed consolidated financial statements

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	December 31, 2002 -----	December 31, 2001 -----
Cash flows from operating activities:		
Net income (loss)	\$ 1,541,926	\$ (343,958)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	264,711	260,159
Stock option income tax benefit	78,660	-
Amortization of intangibles	-	3,333
Amortization of deferred membership fee revenue	-	(118,570)
(Gain) loss on disposal of property and equipment	(15,000)	185,265
Bad debt expense	7,329	7,181
(Increase) decrease in operating assets and liabilities:		
Accounts receivable	(127,154)	6,428
Inventory	(4,337,101)	(1,192,042)
Prepaid expenses and other current assets	(42,307)	(67,773)
Other assets	(150,000)	(43,125)
Accounts payable and accrued expenses	1,987,060	1,293,948
	-----	-----
Net cash used in operating activities	(791,876)	(9,154)
Cash flows from investing activities:		
Net proceeds from the sale of property and equipment	15,000	2,016,921
Purchases of property and equipment	(665,252)	(289,985)
Purchase of intangible asset	(365,000)	-
	-----	-----
Net cash (used in) provided by investing activities	(1,015,252)	1,726,936
	-----	-----
Cash flows from financing activities:		
Payments on capital lease obligations	-	(123,999)
Proceeds from the exercise of stock options and warrants	393,663	-
Payments on loan obligation	(51,332)	-
Borrowings on line of credit	858,786	-
Payments on mortgage payable	-	(1,566,833)
	-----	-----
Net cash provided by (used in) financing activities	1,201,117	(1,690,832)
	-----	-----
Net (decrease) increase in cash and cash equivalents	(606,011)	26,950
Cash and cash equivalents, at beginning of period	737,284	408,699
	-----	-----
Cash and cash equivalents, at end of period	\$ 131,273 =====	\$ 435,649 =====
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 17,287 =====	\$ 25,803 =====
Cash paid for income taxes	\$ 28,000 =====	\$ - =====

See accompanying notes to condensed consolidated financial statements

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PETMED EXPRESS, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1: Summary of Significant Accounting Policies

Organization

PetMed Express, Inc. and subsidiaries is a leading nationwide pet pharmacy. The Company markets prescription and non-prescription pet medications along with health and nutritional supplements for cats and dogs direct to the consumer. The Company offers consumers an attractive alternative for obtaining pet medications in terms of convenience, price, and speed of delivery.

The Company markets its products through national television, on-line and direct mail advertising campaigns, which aim to increase the recognition of the "1-800-PetMeds" brand name, increase traffic on its web site at www.1800PetMeds.com, acquire new customers, and maximize repeat purchases. The Company's executive offices are located in Pompano Beach, Florida.

The Company's fiscal year end is March 31, and references herein to fiscal 2003 or 2002 refer to the Company's fiscal years ending March 31, 2003 and 2002, respectively.

Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-QSB and, therefore, do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position of the Company, after elimination of intercompany accounts and transactions, at December 31, 2002, and the statements of operations for the three and nine months ended December 31, 2002 and cash flows for the nine months ended December 31, 2002. The results of operations for the three and nine months ended December 31, 2002, are not necessarily indicative of the operating results expected for the fiscal year ending March 31, 2003. These financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's annual report on Form 10-KSB for the fiscal year ended March 31, 2002. The condensed consolidated financial statements include the accounts of PetMed Express, Inc. and its wholly owned subsidiaries. All significant intercompany transaction has been eliminated upon consolidation.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities

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and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Earnings (Loss) Per Share

In accordance with the requirements of SFAS No. 128, basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding and diluted earnings per share reflects the dilutive effects of stock options (as calculated utilizing the treasury stock method) and the equivalent common shares of outstanding convertible preferred stock. Options and warrants and the effect of convertible securities were not included in the calculation of diluted loss per share for the nine months ended December 31, 2001, because their effect would have been antidilutive.

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Note 2: Line of Credit

On July 22, 2002, the Company executed an agreement which increased the line of credit to \$1,000,000, effective through June 22, 2003. The line of credit is secured by substantially all of our assets, interest is at the bank's base lending rate (4.25% at January 31, 2003), and contains various financial and operating covenants. In the third quarter of fiscal 2003, the Company utilized the remaining balance of its \$1,000,000 line of credit. The line of credit proceeds were used primarily to increase the Company's inventory levels, in efforts to prepare for the upcoming flea and tick season. At December 31, 2002, there was \$1,000,000 outstanding under the line of credit agreement.

Note 3: Commitments and Contingencies

Legal Matters

Various complaints had been filed with the Florida Board of Pharmacy. These complaints, the majority of which were filed by veterinarians who are in competition with the Company for the sale of pet prescription-required products, alleged violations of the Pharmacy Practice Act and regulations promulgated thereunder. The vast majority of the complaints alleged that the Company, through its pharmacists, improperly dispensed prescription-required veterinary medication based on prescriptions verified through the Company's discontinued alternate veterinarian program. The alternate veterinarian program used a veterinarian outside the state of Florida to verify prescriptions for certain pets outside the state of Florida. While the program was not used for pets residing in the state of Florida, the complaints had, for the most part, been filed with the Florida Board of Pharmacy. Other complaints alleged the dispensing of medication without a valid prescription, the sale of non-conforming products and that the Company's pharmacy was operating at the same location as another pharmacy, with which it had a contractual relationship. The Company contested all allegations and continued discussions in an attempt to reach a resolution of these matters.

In February 2002, the Company voluntarily ceased the use of its alternate veterinarian program, and in March 2002 a business decision

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was made to enter into a settlement agreement with the Florida Board of Pharmacy, rather than to proceed with costly and lengthy litigation. In April 2002, the Florida Board of Pharmacy approved the settlement agreement. The Florida Board of Pharmacy did not reach any finding of fact or conclusion of law that the Company committed any wrongdoing or violated any rules or laws governing the practice of pharmacy. According to the settlement agreement, the Company's pharmacy license was placed on probation for a period of three years and the Company, the Company's pharmacists and contracted pharmacy and pharmacist, paid approximately \$120,000 in fines and investigative costs, in July 2002. The Company remains licensed with the State of Florida and continues to operate its principal business in Florida.

Additional complaints have been filed with other states' Pharmacy Boards. These complaints, the majority of which were filed by veterinarians who are in competition with the Company for the sale of pet prescription-required products, allege violations of the Pharmacy Practice Act and regulations promulgated thereunder. The vast majority of the complaints allege that the Company, through its pharmacists, improperly dispensed prescription-required veterinary medication based on prescriptions verified through the Company's alternate veterinarian program. The Company contested all allegations and continued discussions in an attempt to reach a resolution of these matters.

In fiscal 2003, the Company reached settlement agreements with the Louisiana, Missouri, New Mexico, and Ohio State Pharmacy Boards. According to the settlement agreements, the Company was required to terminate the alternate veterinarian program in the state and the Company's permit was placed on probation. As of December 31, 2002, the Company had paid all fines in full to cover any or all administrative and investigative costs associated with these settlements. At December 31, 2002, there was no accrual relating to these settlements. There can be no assurances made that other states will not attempt to take similar actions against the Company in the future.

In February 2000, the United States Environmental Protection Agency ("EPA") issued a Stop Sale, Use or Removal Order to the Company regarding the alleged distribution or sale of misbranded Advantage products in violation of the Federal Insecticide, Fungicide, and Rodenticide Act ("FIFRA"), as amended. The order provides that the company shall not distribute, sell, use or remove the products listed in the order, which are allegedly misbranded. The order further provides that the Company shall not commence any sale or distribution of those products without the prior written approval from the EPA. The Stop Sale, Use or Removal Order does not assert any claim for monetary damages; rather, it is in the nature of a cease and desist order. The Company denied any alleged violations. On February 16, 2000, the Company submitted a written response to the order. The EPA assessed a fine in the amount of \$445,000. In fiscal 2001 the Company accrued \$445,000 of legal settlement expense.

In September 2001, the Company and the EPA entered into a Consent Agreement and Final Order ("CAFO"). The settlement agreement required the Company to pay a civil penalty of \$100,000 plus interest,

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requiring a payment of \$56,000, which was paid in September 2002, and \$53,000 due on September 30, 2003, a reduction from the previously assessed fine of \$445,000. For the purpose of this CAFO, the Company admitted to the jurisdictional allegations set forth, and neither admitted nor denied the alleged violations. On September 28, 2001, the CAFO was approved and ordered by the regional judicial officer.

On March 19, 2002, Novartis Animal Health U.S., Inc. ("Novartis") filed a complaint against the Company and two other defendants in U.S. District Court for the Southern District of Florida. Novartis purports to assert seven (7) claims related to the Company's alleged sale of pet medications produced for a Novartis Australian sister company: Count I: Infringement of Registered Trademark Under Section 32 of the Lanham Act, 15 U.S.C. Sec. 1114; Count II: Infringement of Unregistered Trademarks Under Section 43(a) of the Lanham Act, 15 U.S.C. Sec. 1125(a); Count III: False Advertising Under Section 43(a) of the Lanham Act, 15 U.S.C. Sec. 1125(a); Count IV: Misleading Advertising Under Florida Statutory Law; Count V: Deceptive and Unfair Trade Practices Under Florida Statutory Law; Count VI: Injury to Business Reputation Under Florida Statutory Law; Count VII: Common Law Unfair Competition.

The Company has answered the complaint and asserted defenses and affirmative defenses. The court issued a scheduling order, which sets the case for trial on the court's November 2003 trial calendar. No discovery has been propounded, and no documents have been produced. The parties have engaged in substantial settlement discussions and agreed on the material terms of settlement; however, at this point, no written settlement agreement has been executed. In the absence of a settlement, the Company would defend itself vigorously, and would likely assert counterclaims. Because the parties have not engaged in substantial discovery, it is not possible at this time to evaluate the likelihood of an unfavorable outcome or estimate any potential loss in the event of an adverse outcome.

The Company is a defendant in a lawsuit in Texas state district court seeking injunctive and monetary relief styled Texas State Board of Pharmacy and State Board of Veterinary Medical Examiners v. PetMed Express, Inc. Cause No. GN-202514, in the 201st Judicial District Court, Travis County, Texas. The Company in its initial pleading denied the allegations contained therein. The Company will vigorously defend, is confident of its compliance with the applicable law, and finds wrong-on-the-facts the vast majority of the allegations contained in the Plaintiffs' supporting documentation attached to the lawsuit. Discovery has recently commenced. At this early stage of the litigation it is difficult to assess any possible outcome or estimate any potential loss in the event of an adverse outcome.

Routine Proceedings

The Company is a party to routine litigation incidental to its business. The Company's management does not believe that the resolution of any or all of such routine litigation is likely to have a material adverse effect on the Company's financial condition or results of operations.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Overview

The Company's common shares are traded on the OTC Bulletin Board ("OTCBB") under the symbol "PETS". On October 3, 2002, the Company submitted an application for listing on the American Stock Exchange. The Company is presently in the review stage, no assurances can be made that the Company will be accepted for listing.

PetMed Express was incorporated in the state of Florida in January 1996. The Company began selling pet medications and products in September 1996, and in the fall of 1997 the Company issued its first catalog. This catalog displayed approximately 1,200 items, including prescription and non-prescription pet medications, pet health and nutritional supplements and pet accessories. In fiscal 2001, the Company focused its product line to approximately 600 of the most popular pet medications for dogs and cats. The Company also markets products on its web site. Since October 1997, the Company has advertised its products on national television and through the direct mailing of catalogs.

The Company's sales consist of products sold to mainly retail consumers and minimal wholesale customers. Typically, the Company's retail customers pay by credit card or check at the time the order is shipped. The Company usually receives cash settlement in one to three banking days for sales paid for by credit cards, which minimizes the accounts receivable balances relative to the Company's sales. Certain wholesale customers are extended credit terms, which usually require payment within 30 days of delivery. For the quarter ended December 31, 2002, the Company's sales returns average was approximately 1.5% of sales, and the average purchase was approximately \$69.

Critical Accounting Policies

Our discussion and analysis of our financial condition and the results of our operations are based upon our condensed consolidated financial statements and the data used to prepare them. The Company's condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. On an ongoing basis we re-evaluate our judgements and estimates including those related to product returns, bad debts, inventories, long-lived assets, income taxes, litigation and contingencies. We base our estimates and judgements on our historical experience, knowledge of current conditions and our beliefs of what could occur in the future considering available information. Actual results may differ from these estimates under different assumptions or conditions. Our estimates are guided by observing the following critical accounting policies.

Revenue recognition

We generate our revenue by selling pet medication products to mainly retail consumers and minimal wholesale customers. Our policy is to recognize revenue from product sales upon shipment, when the rights and risk of ownership have passed to the consumer. Outbound shipping and handling fees are included in sales and are billed upon shipment. Shipping and handling expenses are included in cost of sales.

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The majority of our sales are paid by credit cards and we usually receive the cash settlement in one to three banking days. Credit card sales minimize our account receivable balances relative to our sales. We maintain an allowance for doubtful accounts for losses that we estimate will arise from our customers' inability to make required payments. We make our estimates of the uncollectibility of our accounts receivable by analyzing historical bad debts and current economic trends. At December 31, 2002 the allowance for doubtful accounts was approximately \$10,000.

Valuation of inventory

Inventories consist of prescription and non-prescription pet medications that are available for sale and are priced at the lower of cost or market value using a weighted average cost method. We write down our inventory for estimated obsolescence. At December 31, 2002 the inventory reserve was approximately \$136,000.

Property and equipment

Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets. The furniture, fixtures, equipment and computer software are depreciated over periods ranging from three to ten years. Leasehold improvements and assets under capital lease agreements are amortized over the shorter of the underlying lease agreement or the useful life of the asset.

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Long-lived assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability of assets is measured by comparison of the carrying amount of the asset to net future cash flows expected to be generated from the asset.

Advertising

The Company's advertising expense consists primarily of television advertising, internet marketing, catalog and postcard production, and mailing costs. Television costs are expensed as the ads are televised and catalog and postcard costs are expensed when the related catalog and postcards are produced, distributed or superseded.

Accounting for income taxes

The Company accounts for income taxes under the provisions of SFAS No. 109, Accounting for Income Taxes, which generally requires recognition of deferred tax assets and liabilities for the expected future tax benefits or consequences of events that have been included in the condensed consolidated financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting carrying values and the tax bases of assets and liabilities, and are measured by applying enacted tax rates and laws for the taxable years in which those

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differences are expected to reverse.

Results of Operations

The following should be read in conjunction with the Company's condensed consolidated financial statements and the related notes thereto included elsewhere herein. The following table sets forth, as a percentage of sales, certain items appearing in the Company's condensed consolidated statements of operations.

	Three Months Ended		Nine Months Ended	
	December 31 2002	December 31 2001	December 31 2002	December 31 2001
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales	57.4	56.5	57.2	59.9
Gross profit	42.6	43.5	42.8	40.1
Operating expenses:				
General and administrative	16.3	19.3	14.6	19.8
Advertising	19.1	18.8	21.8	20.3
Severance charges	-	-	-	0.9
Depreciation and amortization	0.9	0.9	0.7	1.2
Total operating expenses	36.3	39.0	37.1	42.2
Income (loss) from operations	6.3	4.5	5.7	(2.1)
Other income (expense):				
Adjustment of estimate for legal settlement	-	-	-	1.6
Gain (loss) on disposal of property and equipment	0.2	-	-	(0.9)
Interest expense	(0.1)	(0.1)	-	(0.2)
Interest income	-	-	-	-
Other, net	-	(0.1)	-	-
Total other income (expense)	0.1	(0.2)	-	0.5
Income (loss) before provision for income taxes	6.4	4.3	5.7	(1.6)
Provision for income taxes	2.4	-	1.9	-
Net income (loss)	4.0	4.3	3.8	(1.6)

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Three Months Ended December 31, 2002 Compared With Three Months Ended December 31, 2001, and Nine Months Ended December 31, 2002 Compared With Nine Months Ended December 31, 2001

Sales

Sales increased by approximately \$2,801,000, or 34.0%, to approximately \$11,050,000 for the quarter ended December 31, 2002, from approximately \$8,249,000 for the quarter ended December 31, 2001. For the nine months ended December 31, 2002, sales increased by approximately \$18,736,000, or 87.7%, to approximately \$40,111,000 compared to sales of \$21,375,000 for the nine months ended December 31, 2001. The increase in sales for the three months and nine months ended December 31, 2002 is primarily due to the positive effects of increased advertising and increased retail reorders, offset by a decrease in wholesale sales.

The Company has committed certain amounts specifically designated towards television advertising to stimulate sales, create brand awareness, and acquire new customers. Retail new order sales have increased by approximately \$9,162,000, or 72.4%, to approximately \$21,810,000 for the nine months ended December 31, 2002, from approximately \$12,648,000 for the nine months ended December 31, 2001. Retail reorder sales have increased by approximately \$11,855,000, or 189.1%, to approximately \$18,124,000 for the nine months ended December 31, 2002, from approximately \$6,269,000 for the nine months ended December 31, 2001. Wholesale sales have decreased by approximately \$2,281,000, or 92.8%, to approximately \$176,000 for the nine months ended December 31, 2002, from approximately \$2,457,000 for the nine months ended December 31, 2001. The Company has discontinued its wholesale operations to concentrate on retail sales.

The majority of our product sales are affected by the seasons, due to the seasonality of mainly heartworm and flea and tick medications. Industry seasonality trends, according to Fountain Agricounsel LLC, Management Consultants to Agribusiness, are divided into percentage of industry sales by quarter. For the quarters ended March 31, June 30, September 30, and December 31 industry sales are 19%, 37%, 28%, and 16%, respectively. The Company cannot accurately predict future sales, however, based on current circumstances the Company does not expect a significant variance compared to the industry standards in the fourth quarter of fiscal 2003.

Cost of sales

Cost of sales increased by approximately \$1,676,000, or 35.9%, to approximately \$6,342,000 for the quarter ended December 31, 2002, from approximately \$4,666,000 for the quarter ended December 31, 2001. For the nine months ended December 31, 2002, cost of sales increased by approximately \$10,141,000, or 79.2%, to approximately \$22,939,000 compared to cost of sales of \$12,798,000 for the nine months ended December 31, 2001. The increase to cost of sales for the three months and nine months ended December 31, 2002 is directly related to the increase to retail sales. However, as a percent of sales, the cost of sales was 57.2% for the nine months ended December 31, 2002, as compared to 59.9% for the nine months ended December 31, 2001. This percentage reduction can be attributed to the Company's continued

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efforts to purchase medications in larger quantities, by bulk, to take advantage of any and all purchasing discounts available.

Gross profit

Gross profit increased by approximately \$1,126,000, or 31.4%, to approximately \$4,709,000 for the quarter ended December 31, 2002 from approximately \$3,583,000 for the quarter ended December 31, 2001. For the nine months ended December 31, 2002, gross profit increased by approximately \$8,594,000, or 100.2%, to approximately \$17,171,000 compared to gross profit of \$8,577,000 for the nine months ended December 31, 2001. Gross profit as a percentage of sales for the nine months ended December 31, 2002 and 2001 was 42.8% and 40.1%, respectively.

General and administrative expenses

General and administrative expense increased by approximately \$211,000, or 13.3%, to approximately \$1,801,000 for the quarter ended December 31, 2002 from approximately \$1,590,000 for the quarter ended December 31, 2001. The increase in general and administrative expense for the third quarter of fiscal 2003 is primarily attributable to a \$171,000 increase to payroll expenses, \$43,000 increase to bank service and credit card fees, \$38,000 increase in property expenses, which includes utilities and rental expenses, \$18,000 increase to insurance expenses, and a \$18,000 increase to telephone expenses, offset with a \$70,000 reduction to professional fees due to the hiring of full time pharmacists, and a \$7,000 decrease to office and other expenses. The increase to payroll expenses can be attributed to the addition of new employees in the sales, customer service and pharmacy departments, which enabled the company to sustain its continued growth.

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For the nine months ended December 31, 2002, general and administrative expense increased by approximately \$1,619,000, or 38.2%, to approximately \$5,859,000 compared to general and administrative expense of \$4,240,000 for the nine months ended December 31, 2001. The increase in general and administrative expense for the nine months ended December 31, 2002 is primarily attributable to a \$1,242,000 increase to payroll expenses, \$438,000 increase to bank service and credit card fees, \$106,000 increase in property expenses, which includes utilities and rental expenses, \$65,000 increase to insurance expenses, and a \$21,000 increase to office and other expenses, offset with a \$160,000 reduction to professional fees due to the hiring of full time pharmacists and reduced legal expenses and a \$93,000 decrease to telephone expenses due to a switch in local and long distance carriers. The increase to payroll expenses can be attributed to the addition of new employees in the sales, customer service and pharmacy departments, which enabled the company to sustain its continued growth.

Advertising expenses

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Advertising expenses increased by approximately \$567,000, or approximately 36.6%, to approximately \$2,116,000 for the quarter ended December 31, 2002 from approximately \$1,549,000 for the quarter ended December 31, 2001. For the nine months ended December 31, 2002, advertising expense increased by approximately \$4,421,000, or 102.0%, to approximately \$8,756,000 compared to advertising expense of \$4,335,000 for the nine months ended December 31, 2001. The increase in advertising expense for the three months and nine months ended December 31, 2002 was due to the Company's plan to commit certain amounts specifically designated towards television advertising to stimulate sales, create brand awareness, and acquire new customers. The Company expects this trend in advertising to continue into the fourth quarter of fiscal 2003.

Severance charges

Severance charges for the nine months ended December 31, 2001 of \$195,000 relates to severance paid to two former executive officers, the Chief Financial Officer and Chief Operating Officer, of the Company. The Company had no comparable charges in the nine months ended December 31, 2002.

Depreciation and amortization expenses

Depreciation and amortization expenses increased by approximately \$23,000, or 30.0%, to approximately \$98,000 for the quarter ended December 31, 2002 from approximately \$75,000 for the quarter ended December 31, 2001. For the nine months ended December 31, 2002, depreciation and amortization expense increased by approximately \$1,000, or 0.5%, to approximately \$265,000 compared to depreciation and amortization expense of \$264,000 for the nine months ended December 31, 2001. The increase to depreciation and amortization expense for the three months and nine months ended December 31, 2002 can be attributed to depreciation expense related to increased property and equipment additions since the first quarter of fiscal 2002, offset with the sale of the corporate office building in the first quarter of fiscal 2002.

Adjustment of estimate for legal settlement

In the second quarter of fiscal 2002, the Company recognized income of \$345,000 on a reversal of a legal assessment estimate, which was originally booked in the fourth quarter of the fiscal year ended March 31, 2001. In September 2001, the Company and the EPA entered into a Consent Agreement and Final Order. The settlement agreement requires the Company to pay a civil penalty of \$100,000 plus interest, a reduction from the original \$445,000 fine.

Gain or loss on disposal of property and equipment

In the third quarter of fiscal 2003, the Company recorded a gain on disposal of computer equipment of \$15,000. The computer equipment was sold to an unrelated third party and the Company received gross proceeds of \$15,000. In the first quarter of fiscal 2002, the Company recorded a loss on disposal of land and building of \$185,000. The loss was a result of the sale of the corporate office building, which includes the principal executive offices and warehouse, to an unrelated third party. The Company received gross proceeds of

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\$2,150,000, of which approximately \$1,561,000 was used to pay off the mortgage.

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Interest expense

Interest expense increased by approximately \$5,000, or 104.9%, to approximately \$9,000 for the quarter ended December 31, 2002 from approximately \$4,000 for the quarter ended December 31, 2001. For the nine months ended December 31, 2002, interest expense decreased by approximately \$26,000, or 58.3%, to approximately \$19,000 compared to interest expense of \$45,000 for the nine months ended December 31, 2001. Interest expense may increase further in future quarters, due to the Company utilizing its \$1,000,000 line of credit to increase inventory levels.

Provision for income taxes

The Company had incurred significant net losses since its inception in 1996. These losses have resulted in net operating loss carryforwards and deferred tax assets, which have been used by the Company to offset tax liabilities, which may have been incurred in prior periods. The Company recorded a valuation allowance against the deferred income tax assets, since future utilization of these assets is subject to the Company's ability to generate taxable income. For the three and nine months ended December 31, 2002, the Company established an income tax provision for approximately \$266,000 and \$757,000, respectively, to provide for taxable income as the utilization of net operating loss carryforwards are limited.

Liquidity and Capital Resources

The Company's working capital at December 31, 2002 was \$1,597,000, as compared to the \$734,000 deficiency at December 31, 2001, an increase of approximately \$2,331,000 from the working capital at December 31, 2001. The increase in working capital at December 31, 2002 was primarily attributable to cash flow generated from operations, which resulted in an increase in inventory, offset with a smaller increase in accounts payable. Net cash used in operating activities was \$792,000 for the nine months ended December 31, 2002 as compared to net cash used in operating activities of \$9,000 for the nine months ended December 31, 2001. Net cash used in investing activities was \$1,015,000 for the nine months ended December 31, 2002 as compared to net cash provided by investing activities of \$1,727,000 for the nine months ended December 31, 2001. This change can be attributed to the receipt of proceeds from the sale of the corporate office building and land in the first quarter of fiscal 2002. Net cash provided by financing activities increased to \$1,201,000 for the nine months ended December 31, 2002 as compared to net cash used in financing activities of \$1,691,000 for the nine months ended December 31, 2001. This increase relates directly to the satisfaction of the mortgage on the corporate office building in fiscal 2002, additional borrowings under the Company's line of credit agreement and the exercise of stock options and warrants in fiscal 2003.

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On May 31, 2001, the Company sold their 50,000 square foot office building, which houses the Company's principal executive offices and warehouse, to an unrelated third party. The Company received gross proceeds of \$2,150,000, of which approximately \$1,561,000 was used to pay off the mortgage, and the Company recognized a loss on the sale of approximately \$185,000. The Company then entered into a five-year term lease agreement for 20,000 of the 50,000 square foot Pompano Beach office building. Then on February 22, 2002, the Company entered into a lease addendum which added approximately 12,000 square feet, effective June 1, 2002, to accommodate the Company's warehouse expansion. According to the lease addendum, all additional costs, approximately \$150,000, associated with tenant improvements related to the warehouse expansion, will be paid by the lessee. These tenant improvements of \$153,000 were capitalized and paid in full in the second quarter of fiscal 2003.

On March 12, 2002, the Company entered into a \$205,000, three year term loan agreement with SouthTrust Bank, with interest accruing at the lending institution's base rate plus 1% (5.25% at January 31, 2003). The loan proceeds were used to purchase a \$250,000 computer server. The aggregate loan maturities are \$68,000 per year for the next three years.

On July 19, 2002 the new warehouse and fulfillment automation project was completed. The Company believes this expansion project has tripled its capacity. The Company had financed certain equipment acquisitions with capital leases, as of December 31, 2002 the Company had no outstanding lease commitments. Other than working capital, credit line, and cash from operations, the Company presently has no other alternative source of working capital. The Company has approximately \$100,000 planned for capital expenditure commitments for various plant and computer equipment for the fourth quarter of fiscal 2003, which will be funded through cash from operations.

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On July 22, 2002, the Company executed an agreement which increased the line of credit to \$1,000,000, effective through June 22, 2003. The line of credit is secured by substantially all of our assets, interest is at the bank's base lending rate (4.25% at January 31, 2003), and contains various financial and operating covenants. In the third quarter of fiscal 2003, the Company utilized the remaining balance of its \$1,000,000 line of credit. The line of credit proceeds were used primarily to increase the Company's inventory levels, in efforts to prepare for the upcoming flea and tick season. At December 31, 2002, there was \$1,000,000 outstanding under the line of credit agreement.

For the year ended March 31, 2001, the Company had incurred significant operating losses and cash flow deficiencies. However, for the year ended March 31, 2002 the Company had net income of \$825,000, and for the nine months ended December 31, 2002 the Company had net income of \$1,542,000, and the Company has sustained profitability for six consecutive quarters. Additionally, the Company has committed certain amounts specifically designated towards advertising to stimulate sales growth. However, increases to advertising may

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negatively impact our short term profitability. The Company may seek to raise additional capital in the future, through the sale of equity securities. No assurances can be given that the Company will be successful in obtaining additional capital, or that such capital will be available in terms acceptable to the Company. At this time, the Company has no commitments or plans to obtain additional capital. Further, there can be no assurances that even if such additional capital is obtained that the Company will sustain profitability or positive cash flow.

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Item 3. Controls and Procedures.

The Company's management, including our Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-14(c) promulgated under the Securities and Exchange Act of 1934, as amended) as of February 10, 2003 (the "Evaluation Date") within 90 days prior to the filing date of this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded, that our disclosure controls and procedures are effective for timely gathering, analyzing and disclosing the information we are required to disclose in our reports filed under the Securities Exchange Act of 1934, as amended. There have been no significant changes made in our internal controls or in other factors that could significantly affect our internal controls subsequent to the Evaluation Date.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 2. Changes in Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders.

None

Item 5. Other Information.

On November 13, 2002, Messrs. Kenneth Jacobi and Huseyin Kizanlikli, members of the Board of Directors of PetMed Express, Inc. (the "Company") resigned. The resignations were not related to a disagreement with the Company on any matter related to the Company's operations, policies or practices. On November 14, 2002 through November 19, 2002, the Company appointed four new board members to its Board of Directors. Joining the Company's Board of Directors are Messrs. Robert C. Schweitzer, Ronald J. Korn, Gian Fulgoni, and the Company's Chief Executive Officer, Menderes Akdag. Each independent Board of Director will be compensated \$10,000 annually, and granted 30,000 stock options to purchase the Company's Common Stock, which will vest equally over a three year period. PetMed Express Inc.'s Independent Board of Directors includes:

Robert C. Schweitzer, age 56, was the Regional President of Union Planters Bank for Broward and Palm Beach County Florida markets from April 1999 to December 2002. Prior to joining Union Planters, Mr. Schweitzer served as the Executive VP and Head of Commercial Banking for Barnett Bank/NationsBank in Jacksonville, Florida from 1993 to 1999. Other positions held include Director and Head of Real Estate Consulting for Coopers & Lybrand in Washington, D.C.; Senior VP and Manager of Central North America Real Estate for the First National Bank of Chicago, and Manager of Domestic Credit Process Review; Senior VP & Manager of Central North American Banking for Wachovia Bank. Mr. Schweitzer holds an MBA from the University of North Carolina, and a Bachelor of Science degree from the United States Naval Academy.

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Ronald J. Korn, age 62, has been the President of Ronald Korn Consulting since 1991. He served as the Managing Partner of KPMG, LLP's Miami office from 1985 to 1991. Mr. Korn held various positions including Partner with KPMG from 1961 until 1991. He has served as a Director and Chairman of the Audit Committee of Engle Homes, Inc. since 1992, and a Director, Chairman of the Audit Committee, and member of the Loan Committee of Horizon Bank, FSB since 1999. Mr. Korn previously served as a Director and Chairman of the Audit Committee of Vacation Break U.S.A., Inc. and Magicworks Entertainment Corporation, and Non-Executive Chairman of Carole Korn Interiors, Inc. He is an Associate Member of the American Institute of Certified Public Accountants. Mr. Korn holds a Juris Doctor degree from the New York University Law School and a Bachelor of Science degree in Economics from the University of Pennsylvania, Wharton School.

Gian Fulgoni, age 54, has been the Executive Chairman of ComScore Networks, Inc. since 1999. From 1981 until 1998, Mr. Fulgoni served as president and chief executive officer of Information Resources, Inc. (IRIC: NASDAQ). He was a member of our Board of Directors from August 1999 through November 2000. Mr. Fulgoni currently serves as a member of the Board of Directors of Easter Seals, Chicago. Mr. Fulgoni served on the Board of Directors of Platinum Technology, Inc. from 1990 to 1999, U.S. Robotics, Inc. from 1991 to 1994, and Yesmail.com, Inc. in 1999. Educated in the U.K., Mr. Fulgoni holds a Masters degree in Marketing from the University of Lancaster and a Bachelor of Science degree in Physics from the University of Manchester.

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Item 6. Exhibits and Reports on Form 8-K.

- (a) The following exhibits are filed as part of this report.
 - 99.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350 (filed herewith to Exhibit 99.1 of the Registrant's Report on Form 10-QSB for the quarter ended December 31, 2002, Commission File No. 000-28827).
 - 99.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 (filed herewith to Exhibit 99.2 of the Registrant's Report on Form 10-QSB for the quarter ended December 31, 2002, Commission File No. 000-28827).
- (b) Reports on Form 8-K during the fiscal quarter ended December 31, 2002
 - (1) On November 20, 2002 the Company filed a report under Item 5 disclosing other events relating to the addition and resignation on certain members of the Board of Directors.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PETMED EXPRESS, INC.
(The "Registrant")

Date: February 10, 2003

By: /s/ Menderes Akdag
Menderes Akdag

Chief Executive Officer
(principal executive officer)

By: /s/ Bruce S. Rosenbloom
Bruce S. Rosenbloom

Chief Financial Officer
(principal financial and accounting officer)

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CERTIFICATION

I, MENDERES AKDAG, certify that:

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1. I have reviewed this quarterly report on Form 10-QSB of PetMed Express, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls.

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

February 10, 2003

By: /s/ Menderes Akdag

Menderes Akdag

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Chief Executive Officer

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CERTIFICATION

I, BRUCE S. ROSENBLOOM, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of PetMed Express, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

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b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls.

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

February 10, 2003

By: /s/ Bruce S. Rosenbloom

Bruce S. Rosenbloom
Chief Financial Officer

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

PETMED EXPRESS, INC.

FORM 10-QSB QUARTERLY REPORT

FOR THE QUARTER ENDED:

DECEMBER 31, 2002

EXHIBITS

EXHIBIT INDEX

Exhibit Number	Description	Number of Pages in Original Document +	Incorporated By Reference
99.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350	1	**
99.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350	1	**
**	Filed herewith		