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PETMED EXPRESS INC  
Form 10-K  
June 04, 2007

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended March 31, 2007

OR

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.

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(Exact name of Registrant as specified in its charter)

FLORIDA

65-0680967

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(State or other jurisdiction of  
incorporation or organization)

(IRS Employer  
Identification No.)

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

33069

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(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (954) 979-5995

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Securities registered under Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

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COMMON STOCK, \$.001 PAR VALUE

The NASDAQ Stock Market LLC  
(NASDAQ Global Select Market)

Securities registered under Section 12(g) of the Act:

NONE

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Indicate by check mark if the registrant is a well-known  
seasoned issuer, as defined in Rule 405 of the Securities  
Act. Yes  No

Indicate by check mark if the registrant is not required to  
file reports pursuant to Section 13 or Section 15(d) of the

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Act. Yes [ ] No[X]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" or "large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

The aggregate market value of the common stock held by non-affiliates of the registrant as of September 30, 2006, the last business day of the registrant's most recently completed second fiscal quarter, was \$240,377,000 based on the closing sales price for the Registrant's Common Stock on that date, as reported on the NASDAQ Global Select Market.

The number of shares of the Registrant's Common Stock outstanding as of June 1, 2007 was 24,335,781.

DOCUMENTS INCORPORATED BY REFERENCE

Information to be set forth in our Proxy Statement relating to our 2007 Annual Meeting of Stockholders to be held on August 3, 2007 is incorporated by reference in Items 10, 11, 12, 13, and 14 of Part III of this report.

PETMED EXPRESS, INC.

2007 Annual Report on Form 10-K

TABLE OF CONTENTS

	Page
	----
PART I.....	1
Item 1. Business.....	1
Item 1A. Risk Factors.....	5
Item 1B. Unresolved Staff Comments.....	9
Item 2. Properties.....	9
Item 3. Legal Proceedings.....	10

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Item 4. Submission of Matters to a Vote of Security Holders.....	10
PART II.....	11
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.....	11
Item 6. Selected Financial Data.....	13
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	14
Item 7A. Quantitative and Qualitative Disclosures About Market Risk.....	21
Item 8. Financial Statements and Supplementary Data.....	22
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.....	41
Item 9A. Controls and Procedures.....	41
Item 9B. Other Information.....	41
PART III.....	42
Item 10. Directors, Executive Officers, and Corporate Governance.....	42
Item 11. Executive Compensation.....	42
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.....	42
Item 13. Certain Relationships and Related Transactions, and Director Independence.....	42
Item 14. Principal Accounting Fees and Services.....	42
PART IV.....	43
Item 15. Exhibits, Financial Statement Schedules.....	43
SIGNATURES.....	45

### PART I

#### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain information in this Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify these forward-looking statements by the words "believes," "intends," "expects," "may," "will," "should," "plan," "projects," "contemplates," "intends," "budgets," "predicts," "estimates," "anticipates," or similar expressions. These statements are based on our beliefs, as well as assumptions we have used based upon information

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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 Annual Report.

When used in this Annual Report on Form 10-K, "PetMed Express," "1-800-PetMeds," "PetMed," "PetMed Express.com," "the Company," "we," "our," and "us" refer to PetMed Express, Inc. and our subsidiaries.

### ITEM 1. BUSINESS

#### General

PetMed Express, Inc. and subsidiaries, d/b/a 1-800-PetMeds, is a leading nationwide pet pharmacy. The Company markets prescription and non-prescription pet medications, and other health products for dogs, cats, and horses 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, online, and direct mail/print advertising campaigns, which aim to increase the recognition of the "1-800-PetMeds" brand name, increase traffic on its website at [www.1800petmeds.com](http://www.1800petmeds.com), acquire new customers, and maximize

repeat purchases. Our fiscal year end is March 31, our executive offices are located at 1441 S.W. 29th Avenue, Pompano Beach, Florida 33069, and our telephone number is (954) 979-5995. The information contained on the Company's website is not part of our Annual Report.

#### Our Products

We offer a broad selection of products for dogs, cats, and horses. These products include a majority of the well-known brands of medication, such as Frontline Plus<sup>®</sup>, K9 Advantix<sup>®</sup>, Advantager<sup>®</sup>, Heartgard Plus<sup>®</sup>, Sentinel<sup>®</sup>, Intercept<sup>®</sup>, Program<sup>®</sup>, Revolution<sup>®</sup>, Deramaxx<sup>®</sup>, and Rimadyl<sup>®</sup>. Generally, our prices are competitive with the prices for medications charged by veterinarians and retailers.

We research new products, and regularly select new products or the latest generation of existing products to become part of our product selection. In addition, we also refine our current products to respond to changing consumer-purchasing habits. Our website is designed to give us the flexibility to change featured products or promotions. Our product line provides customers with a wide variety of selections across the most popular health categories for dogs, cats, and horses. Our current products include:

Non-Prescription Medications (OTC): Flea and tick control products, bone and joint care products, vitamins and

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nutritional supplements, and hygiene products.

Prescription Medications (Rx): Heartworm treatments, thyroid and arthritis medications, antibiotics, and other specialty medications, as well as generic substitutes.

1

### Sales

The following table provides a breakdown of the percentage of our total sales by each category during the indicated periods:

	Year Ended March 31,		
	2007	2006	2005
	-----	-----	-----
Non-prescription medications	70%	70%	69%
Prescription medications	29%	29%	30%
Shipping and handling charges and other	1%	1%	1%
	-----	-----	-----
Total	100%	100%	100%
	=====	=====	=====

We offer our products through three main sales channels: Internet through our website, telephone contact center through our toll-free number, and direct mail/print through the 1-800-PetMeds catalog and postcards. We have designed both our catalog and website to provide a convenient, cost-effective and informative shopping experience that encourages consumers to purchase products important for a pet's health and quality of life. We believe that these multiple channels allow us to increase the visibility of our brand name and provide customers with increased shopping flexibility and service.

### Internet

We seek to combine our product selection and pet health information with the shopping ease of the Internet to deliver a convenient and personalized shopping experience. Our website offers health and nutritional product selections for dogs, cats, and horses, and relevant editorial and easily obtainable or retrievable resource information. From our home page, customers can search our website for products and access resources on a variety of information on dogs, cats, and horses. Customers can shop at our website by category, product line or individual product. We attracted approximately 14 million visitors to our website during fiscal year 2007, approximately 9% of those visitors placed

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an order, and our website generated approximately 62% of our total sales for the same time period.

In February 2006, we began sponsorship of a new website called "PetHealth101" which is located at [www.PetHealth101.com](http://www.PetHealth101.com). In PetHealth101, pet owners have

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access to health information covering pets' behavior and illnesses-and to the natural and pharmaceutical remedies specifically for a pet's problems. PetHealth101 is updated with the latest research for pet owners.

### Telephone Contact Center

Our customer care representatives receive and process inbound customer calls, facilitate our outbound campaigns around maximizing customers' reorders, facilitate our live web chat, and process customer e-mails. Our telephone system is equipped with certain features including pop-up screens and call blending capabilities that give us the ability to efficiently utilize our customer care representatives' time, providing excellent customer care, service, and support. Our customer care representatives receive a base salary and are rewarded with commissions for sales, and bonuses and other awards for achieving certain goals.

### Direct Mail/Print

The 1-800-PetMeds catalog is a full-color catalog that features our most popular products. The catalog is produced by a combination of in-house writers, production artists, and independent contractors. We mail catalogs and postcards in response to requests generated from our advertising and as part of direct mail campaigns to our customers.

### Our Customers

Approximately 1,900,000 customers have purchased from us within the last two years. We attracted approximately 681,000 and 624,000 new customers in fiscal 2007 and 2006, respectively. Our customers are located throughout the United States, with approximately 50% of customers residing in California, Florida, Texas, New York, Pennsylvania, New Jersey, and Virginia.

While our primary focus has been on retail customers, we have also sold various non-prescription medications wholesale to a variety of businesses, including pet stores, groomers and traditional retailers in the United States. For the fiscal year ended March 31, 2007, the majority of our sales were made to retail customers with less than 1% of our sales made to wholesale customers. The average retail purchase was approximately \$79 for fiscal 2007 compared to \$77 for fiscal 2006.

### Marketing

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The goal of our marketing strategy is to build brand recognition, increase customer traffic, add new customers, build strong customer loyalty, maximize reorders, and develop incremental revenue opportunities. We have an integrated marketing campaign that includes television advertising, direct mail/print and e-mail, and online marketing.

### Television Advertising

Our television advertising is designed to build brand equity, create brand awareness, and generate initial purchases of products via the telephone and the Internet. We have used :30 and :15 second television commercials to attract new customer orders. Our television commercials typically focus on our ability to rapidly deliver to customers the same medications offered by veterinarians, but at reduced prices. We generally purchase advertising on national cable channels to target our key demographic groups. We believe that television advertising is particularly effective and instrumental in building brand awareness.

In January 2007, we began featuring Betty White in our new 2007 advertising campaign, including in new commercials airing nationally. Ms. White speaks to pet owners from her home about the savings and convenience of purchasing the same exact pet medications from 1-800-PetMeds, compared to purchasing the medications from a veterinarian.

### Direct Mail/Print and E-mail

We use direct mail/print and e-mail to acquire new customers and to remind our existing customers to reorder.

### Online Marketing

We supplement our traditional advertising with online advertising and marketing efforts. We make our brand available to internet consumers by purchasing targeted keywords and achieving prominent placement on the top search engines and search engine networks, including Google, Microsoft Network, and Yahoo. We are also members of the LinkShare Network, which is an affiliate program with merchant clients and affiliate websites. This network is designed to develop and build a long-term, branded affiliate program in order to increase online sales and establish an Internet presence. The LinkShare Network enables us to establish link arrangements with other websites, as well as with portals and search engines.

### Operations

#### Purchasing

We purchase our products from a variety of sources, including certain manufacturers, domestic distributors, and wholesalers. We have multiple suppliers for each of our products to obtain the lowest cost. We purchase the majority of our health and nutritional supplements directly from manufacturers. We believe having strong relationships

with product manufacturers will ensure the availability of an adequate volume of products ordered by our customers, and will enable us to provide more and better product information. Historically, substantially all the major manufacturers of prescription and non-prescription medications have declined to sell these products to direct marketing companies. (See Risk Factors.) Part of our growth strategy includes developing direct relationships with the leading pharmaceutical manufacturers of the more popular prescription and non-prescription medications.

#### Order Processing

We provide our customers with toll-free telephone access to our customer care representatives. Our call center generally operates from 8:00 AM to 11:00 PM Monday through Thursday, 8:00 AM to 9:00 PM on Friday, 9:00 AM to 6:00 PM on Saturday, and 10:00 AM to 5:00 PM on Sunday, Eastern Standard Time. The process of customers purchasing products from 1-800-PetMeds consists of a few simple steps. A customer first places a call to our toll-free telephone number or visits our website. The following information is needed to process prescription orders: general pet information, prescription information, and the veterinarian's name and phone number. This information is entered into our computer system. Then our pharmacists and pharmacy technicians verify all prescriptions. The order process system checks for the verification for prescription medication orders and a valid payment method for all orders. An invoice is generated and printed in our fulfillment center, where items are picked for shipping. The product(s) in the customer's order are then selected from the Company's inventory and shipped via United States Priority Mail, United Parcel Service, or Federal Express. Our customers enjoy the convenience of rapid home delivery, with approximately 72% of all orders being shipped within 24 hours of ordering. Our website allows customers to easily browse and purchase substantially all of our products online. Our website is designed to be fast, secure, and easy to use with order and shipping confirmations, and with online order tracking-capabilities.

3

#### Warehousing and Shipping

We inventory our products and fill all customer orders from our 50,000 square foot facility in Pompano Beach, Florida. We have an in-house fulfillment and distribution operation, which is used to manage the entire supply chain, beginning with the placement of the order, continuing through order processing, and then fulfilling and shipping of the product to the customer. We offer a variety of shipping options, including next day delivery. We ship to anywhere in the United States served by the United States Postal Service, United Parcel Service, or Federal Express. Priority orders are expedited in our fulfillment process. Our goal is to ship the products the same day that the order is received. For prescription medications, our goal is to

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ship the product immediately after the prescription has been authorized by the customer's veterinarian.

### Customer Service and Support

We believe that a high level of customer service and support is critical in retaining and expanding our customer base. Customer care representatives participate in ongoing training programs under the supervision of our training managers. These training sessions include a variety of topics such as product knowledge, computer usage, customer service tips, and the relationship between our Company and veterinarians. Our customer care representatives respond to customers' e-mails and calls that are related to order status, prices, and shipping. Our customer care representatives also respond to customers through our live web chat. If our customer care representatives are unable to respond to a customer's inquiry at the time of a call, we strive to provide an answer within 24 hours. We believe our customer care representatives are a valuable source of feedback regarding customer satisfaction. Our customer returns and credits average approximately 1.7 % of total sales.

### Technology

We utilize integrated technologies in call center, e-commerce, order entry, and inventory control/fulfillment operations. Our systems are custom configured by the Company to optimize our computer telephone integration and mail-order processing. The systems are designed to maintain a large database of specialized information and process a large volume of orders efficiently and effectively. Our systems provide our agents with real time product availability information and updated customer information to enhance our customer service. We also have an integrated direct connection for processing credit cards to ensure that a valid credit card number and authorization have been received at the same time our customer care representatives are on the phone with the customer or when a customer submits an order on our website. Our information systems provide our customer care representatives with records of all prior contact with a customer, including the customer's address, phone number, e-mail address, fax number, prescription information, order history, payment history, and notes.

### Competition

The pet medications market is competitive and highly fragmented. Our competitors consist of veterinarians, traditional retailers, and other mail-order and online retailers of pet medications and other health products. We believe that the following are the principal competitive factors in our market:

- \* Product selection and availability, including the availability of prescription and non-prescription medications;
- \* Brand recognition;
- \* Reliability and speed of delivery;
- \* Personalized service and convenience;

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- \* Price; and
- \* Quality of website content.

We compete with veterinarians in the sale of prescription and non-prescription pet medications and other health products. Many pet owners may prefer the convenience of purchasing their pet medications or other health products at the time of a veterinarian visit, or may be hesitant to offend their veterinarian by not purchasing these products from the veterinarian. In order to effectively compete with veterinarians, we must continue to educate pet owners about the service, convenience, and savings offered by our Company.

According to the American Pet Products Manufacturers Association, pet spending in the United States increased 5.8% to \$38.4 billion in 2006. Pet supplies and medications represented \$9.3 billion, or 24% of the total spending on pets in the United States. The pet medication market size is estimated to be approximately \$3.2 billion, with veterinarians having the majority of the market share. The dog and cat population is approximately 163 million, with approximately 63% of all households owning a pet.

4

We believe that the following are the main competitive strengths that differentiate 1-800-PetMeds from the competition:

- \* "1-800-PetMeds" brand name;
- \* Exceptional customer service and support;
- \* Consumer benefit structure of savings and convenience;
- \* Licensed pharmacy to conduct business in 50 states; and
- \* Multiple sources of supply of pet medications.

### Intellectual Property

We conduct our business under the trade name "1-800-PetMeds." We believe this name, which is also our toll-free telephone number, has added significant value and is an important factor in the marketing of our products. We have also obtained the right to the Internet addresses [www.1800petmeds.com](http://www.1800petmeds.com), [www.1888petmeds.com](http://www.1888petmeds.com), [www.petmedexpress.com](http://www.petmedexpress.com),  
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and [www.petmeds.com](http://www.petmeds.com). As with phone numbers, we do not have  
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and cannot acquire any property rights in an Internet address. We do not expect to lose the ability to use the Internet addresses; however, there can be no assurance in this regard and the loss of these addresses may have a material adverse effect on our financial position and results of operations. We are the exclusive owners of United States Trademark Registrations for "PetMed Express[R]," "1888PetMeds[R]," "1-800-PetMeds[R]," and "PetMeds[R]."

### Government Regulation

Dispensing prescription medications is governed at the

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state level by the Board of Pharmacy, or similar regulatory agencies, of each state where prescription medications are dispensed. We are subject to regulation by the State of Florida and are licensed by the Florida Board of Pharmacy. Our current license is valid until February 28, 2009. We are also licensed and/or regulated by 49 other state pharmacy boards and other regulatory authorities including, but not necessarily limited to, the United States Food and Drug Administration ("FDA") and the United States Environmental Protection Agency. As a licensed pharmacy in the State of Florida, we are subject to the Florida Pharmacy Act and regulations promulgated thereunder. To the extent that we are unable to maintain our license as a community pharmacy with the Florida Board of Pharmacy, or if we do not maintain the licenses granted by other state pharmacy boards, or if we become subject to actions by the FDA, or other enforcement regulators, our distribution of prescription medications to pet owners could cease, which could have a material adverse effect on our operations.

### Employees

We currently have 216 full time employees, including: 115 in customer care and marketing; 30 in fulfillment and purchasing; 59 in our pharmacy; 3 in information technology; 4 in administrative positions; and 5 in management. None of our employees are represented by a labor union, or governed by any collective bargaining agreements. We consider relations with our employees to be satisfactory.

### ITEM 1A. RISK FACTORS

You should carefully consider the risks and uncertainties described below, and all the other information included in this Annual Report before you decide to invest in our common stock. Any of the following risks could materially adversely affect our business, financial condition or operating results and could result in a loss of your investment.

There can be no assurances that we can sustain profitable operations in future periods.

We reported net income of \$14,444,000, \$12,064,000, and \$8,010,000 for the fiscal years ended March 31, 2007, 2006, and 2005, respectively. Our profitability during fiscal 2007 was due to increases in our reorder and new order revenue. There are no assurances we will continue to generate revenues at this increased level, or that we will remain profitable during fiscal 2008 and beyond. If our operations were to cease being profitable, our liquidity in future periods would be adversely affected.

We may fail to comply with various state regulations covering the dispensing of prescription pet medications. We could be subject to reprimands, sanctions, probations, fines, suspensions, or the loss of one or more of our

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pharmacy licenses.

The sale and delivery of prescription pet medications is generally governed by state laws and state regulations. Since our pharmacy is located in the State of Florida, the Company is governed by the laws and regulations of the State of Florida. Each prescription pet medication sale we make is likely also to be covered by the laws of the state where the customer is located. The laws and regulations relating to the sale and delivery of prescription pet medications vary from state to state, but generally require that prescription pet medications be dispensed with the authorization from a prescribing veterinarian. To the extent that we are unable to maintain our license as a community pharmacy with the Florida Board of Pharmacy, or if we do not maintain the licenses granted by other state boards, or if we become subject to actions by the FDA, or other enforcement regulators, our distribution of prescription medications to pet owners could cease, which could have a material adverse effect on our operations.

While we make every effort to fully comply with the applicable state rules, laws and regulations, from time to time we have been the subject of administrative complaints regarding the authorization of prescriptions prior to shipment. We cannot assure you that we will not continue to be the subject of administrative complaints in the future. We cannot guarantee you that we will not be subject to reprimand, sanctions, probations, or fines, or that one or more of our pharmacy licenses may not be suspended or revoked. See Item 3. Legal Proceedings.

We currently purchase a portion of our prescription and non-prescription medications from third party distributors and we are not an authorized distributor of these products. We do not have any guaranteed supply of these medications at any pre-established prices.

For the fiscal years ended March 31, 2007 and 2006, the majority of our sales were attributable to sales of prescription and non-prescription medications. Historically, substantially all the major pharmaceutical manufacturers have declined to sell prescription and non-prescription pet medications directly to us. In order to assure a supply of these products, we purchase medications from various secondary sources, including a variety of domestic distributors. Our business strategy includes seeking to establish direct purchasing arrangements with major pet pharmaceutical manufacturing companies. If we are not successful in achieving this goal, we will continue to rely upon secondary sources.

We cannot guarantee that if we continue to purchase prescription and non-prescription pet medications from secondary sources that we will be able to purchase an adequate supply to meet our customers' demands, or that we will be able to purchase these products at competitive prices. As these products represent a significant portion of our sales, our failure to fill customer orders for these products could adversely impact our sales. If we are forced to pay higher prices for these products to ensure an adequate supply, we cannot guarantee that we will be able to

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pass along to our customers any increases in the prices we pay for these medications. This inability to pass along increased prices could materially adversely affect our financial condition and results of operations.

Our failure to properly manage our inventory may result in excessive inventory carrying costs, which could materially adversely affect our financial condition and results of operations.

Our current product line contains approximately 750 SKUs. A significant portion of our sales is attributable to products representing approximately 90 SKUs. We need to properly manage our inventory to provide an adequate supply of these products and avoid excessive inventory of the products representing the balance of the SKUs. We generally place orders for products with our suppliers based upon our internal estimates of the amounts of inventory we will need to fill future orders. These estimates may be significantly different from the actual orders we receive. In the event that subsequent orders fall short of original estimates, we may be left with excess inventory. Significant excess inventory could result in price discounts and increased inventory carrying costs. Similarly, if we fail to have an adequate supply of some SKUs, we may lose sales opportunities. We cannot guarantee that we will maintain appropriate inventory levels. Any failure on our part to maintain appropriate inventory levels may have a material adverse effect on our financial condition and results of operations.

6

Resistance from veterinarians to authorize prescriptions, or attempts/efforts on their part to discourage pet owners to purchase from internet pharmacies could cause our sales to decrease and could materially adversely affect our financial condition and results of operations.

Since we began our operations some veterinarians have resisted providing our customers with a copy of their pet's prescription or authorizing the prescription to our pharmacy staff, thereby effectively preventing us from filling such prescriptions under state law. Some veterinarians have also tried to discourage pet owners from purchasing from internet pharmacies. Sales of prescription medications represented approximately 29% of our sales for the fiscal year. Although veterinarians in some states are required by law to provide the pet owner with this prescription information, if the number of veterinarians who refuse to authorize prescriptions should increase, or if veterinarians are successful in discouraging pet owners from purchasing from internet pharmacies, our sales could decrease and our financial condition and results of operations may be materially adversely affected.

Significant portions of our sales are made to residents of seven states. If we should lose our pharmacy license in one or more of these states, our financial condition and results

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of operations would be materially adversely affected.

While we ship pet medications to customers in all 50 states, approximately 50% of our sales for the fiscal year ended March 31, 2007 were made to customers located in the states of California, Florida, Texas, New York, Pennsylvania, New Jersey, and Virginia. If for any reason our license to operate a pharmacy in one or more of those states should be suspended or revoked, or if it is not renewed, our financial condition and results of operations may be materially adversely affected.

We face significant competition from veterinarians and traditional and online retailers and may not be able to compete profitably with them.

We compete directly and indirectly with veterinarians for the sale of pet medications and other health products. Veterinarians hold a competitive advantage over us because many pet owners may find it more convenient or preferable to purchase these products directly from their veterinarians at the time of an office visit. We also compete directly and indirectly with both online and traditional retailers of pet medications and health and nutritional supplements. Both online and traditional retailers may hold a competitive advantage over us because of longer operating histories, established brand names, greater resources, and/or an established customer base. Online retailers may have a competitive advantage over us because of established affiliate relationships to drive traffic to their website. Traditional retailers may hold a competitive advantage over us because pet owners may prefer to purchase these products from a store instead of online or through catalog or telephone methods. In order to effectively compete in the future, we may be required to offer promotions and other incentives, which may result in lower operating margins or adversely affect the results of operations.

We also face a significant challenge from our competitors forming alliances with each other, such as those between online and traditional retailers. These relationships may enable both their retail and online stores to negotiate better pricing and better terms from suppliers by aggregating the demand for products and negotiating volume discounts which could be a competitive disadvantage to us.

The content of our website could expose us to various kinds of liability, which, if prosecuted successfully, could negatively impact our business.

Because we post product information and other content on our website, we face potential liability for negligence, copyright infringement, patent infringement, trademark infringement, defamation, and/or other claims based on the nature and content of the materials we post. Various claims have been brought, and sometimes successfully prosecuted, against Internet content distributors. We could be exposed to liability with respect to the unauthorized duplication of content or unauthorized use of other parties' proprietary technology. Although we maintain general liability insurance, our insurance may not cover potential claims of this type, or may not be adequate to indemnify us for all

liability that may be imposed. Any imposition of liability that is not covered by insurance, or is in excess of insurance coverage, could materially adversely affect our financial condition and results of operations.

7

We may not be able to protect our intellectual property rights, and we may be found to infringe on the proprietary rights of others.

We rely on a combination of trademarks, trade secrets, copyright laws, and contractual restrictions to protect our intellectual property rights. These afford only limited protection. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy our non-prescription private label generic equivalents, when and if developed, as well as aspects of our sales formats, or to obtain and use information that we regard as proprietary, including the technology used to operate our website and our content, and our trademarks.

Litigation or proceedings before the United States Patent and Trademark Office or other bodies may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets and domain names, and to determine the validity and scope of the proprietary rights of others. Any litigation or adverse priority proceeding could result in substantial costs and diversion of resources, and could seriously harm our business and operating results.

Third parties may also claim infringement by us with respect to past, current, or future technologies. We expect that participants in our markets will be increasingly involved in infringement claims as the number of services and competitors in our industry segment grows. Any claim, whether meritorious or not, could be time-consuming, result in costly litigation, cause service upgrade delays, or require us to enter into royalty or licensing agreements. These royalty or licensing agreements might not be available on terms acceptable to us or at all. See Item 3. Legal Proceedings.

If we are unable to protect our Internet addresses or to prevent others from using Internet addresses that are confusingly similar, our business may be adversely impacted.

Our Internet addresses, [www.1800petmeds.com](http://www.1800petmeds.com), [www.1888petmeds.com](http://www.1888petmeds.com),  
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[www.petmedexpress.com](http://www.petmedexpress.com), and [www.petmeds.com](http://www.petmeds.com) are critical to our  
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brand recognition and our overall success. If we are unable to protect these Internet addresses, our competitors could capitalize on our brand recognition. We are aware of substantially similar Internet addresses, including [www.petmed.com](http://www.petmed.com), used by  
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competitors. Governmental agencies and their designees generally regulate the acquisition and maintenance of Internet addresses. The regulation of Internet addresses in the United States and in foreign countries has changed, and may undergo further change in the near future. Furthermore, the relationship between regulations governing Internet addresses and laws protecting trademarks and similar proprietary rights is unclear. Therefore, we may not be able to protect our own Internet addresses, or prevent third parties from acquiring Internet addresses that are confusingly similar to, infringe upon, or otherwise decrease the value of our Internet addresses.

Since all of our operations are housed in a single location, we are more susceptible to business interruption in the event of damage to or disruptions in our facility.

Our headquarters and distribution center are located in the same building in South Florida, and all of our shipments of products to our customers are made from this sole distribution center. We have no present plans to establish any additional distribution centers or offices. Because we consolidate our operations in one location, we are more susceptible to power and equipment failures, and business interruptions in the event of fires, floods, and other natural disasters than if we had additional locations. Furthermore, because we are located in South Florida, which is a hurricane-sensitive area, we are particularly susceptible to the risk of damage to, or total destruction of, our headquarters and distribution center and surrounding transportation infrastructure caused by a hurricane. We cannot assure you that we are adequately insured to cover the amount of any losses relating to any of these potential events, business interruptions resulting from damage to or destruction of our headquarters and distribution center, or power and equipment failures relating to our call center or websites, or interruptions or disruptions to major transportation infrastructure, or other events that do not occur on our premises.

A portion of our sales are seasonal and our operating results are difficult to predict and may fluctuate.

Because our operating results are difficult to predict, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. The majority of our product sales are affected by the seasons, due to the seasonality of mainly heartworm and flea and tick medications. Seasonality trends are divided into percentage of sales by quarter. For the quarters ended June 30, 2006, September 30, 2006, December 31, 2006, and March 31, 2007, Company sales were 31%, 27%, 19%, and 23%, respectively.

In addition to the seasonality of our sales, our annual and quarterly operating results have fluctuated in the past and may fluctuate significantly in the future due to a variety of factors, many of which are out of our control.

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Factors that may cause our operating results to fluctuate include:

- \* Our ability to obtain new customers at a reasonable cost, retain existing customers, or encourage reorders;
- \* Our ability to increase the number of visitors to our website, or our ability to convert visitors to our website into customers;
- \* The mix of medications and other pet products sold by us;
- \* Our ability to manage inventory levels or obtain an adequate supply of products;
- \* Our ability to adequately maintain, upgrade and develop our website, the systems that we use to process customers' orders and payments, or our computer network;
- \* Increased competition within our market niche;
- \* Price competition;
- \* Increases in the cost of advertising;
- \* The amount and timing of operating costs and capital expenditures relating to expansion of our product line or operations; and
- \* Disruption of our toll-free telephone service, technical difficulties, systems and Internet outages, or slowdowns.

Any change in one or more of these factors could materially adversely affect our financial condition and results of operations in future periods.

Our stock price fluctuates from time to time and may fall below expectations of securities analysts and investors, and could subject us to litigation, which may result in you suffering a loss on your investment.

The market price of our common stock may fluctuate significantly in response to a number of factors, some of which are beyond our control. These factors include: quarterly variations in operating results; changes in accounting treatments or principles; announcements by us or our competitors of new products and services offerings, significant contracts, acquisitions or strategic relationships; additions or departures of key personnel; any future sales of our common stock or other securities; stock market price and volume fluctuations of publicly-traded companies; and general political, economic, and market conditions.

In some future quarter our operating results may fall below the expectations of securities analysts and investors, which could result in a decrease in the trading price of our common stock. In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. We may be the targets of similar litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources, which could seriously harm our business and operating results.

We may issue additional shares of preferred stock that could defer a change of control or dilute the interests of our common stockholders. Our charter documents could defer a takeover effort which could inhibit your ability to receive an acquisition premium for your shares.

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Our charter permits our Board of Directors to issue up to 5,000,000 shares of preferred stock without stockholder approval. Currently there are 2,500 shares of our Convertible Preferred Stock issued and outstanding. This leaves 4,997,500 shares of preferred stock available for issuance at the discretion of our Board of Directors. These shares, if issued, could contain dividend, liquidation, conversion, voting, or other rights which could adversely affect the rights of our common stockholders and which could also be utilized, under some circumstances, as a method of discouraging, delaying or preventing a change in control. Provisions of our articles of incorporation, bylaws and Florida law could make it more difficult for a third party to acquire us, even if many of our stockholders believe it is in their best interest.

### ITEM 1B. UNRESOLVED STAFF COMMENTS

None

### ITEM 2. PROPERTIES

Our facilities, including our principal executive offices, are located at 1441 S.W. 29th Avenue, Pompano Beach, Florida 33069. The Company leases its 50,000 square foot executive offices and warehouse facility under a non-cancelable operating lease, through May 31, 2009. The Company is responsible for certain maintenance costs, taxes, and insurance under this lease. The future minimum annual lease payments are as follows: \$500,000 for fiscal 2008, \$520,000 for fiscal 2009, and \$87,000 for fiscal 2010.

9

### ITEM 3. LEGAL PROCEEDINGS

On January 19, 2006, PetMed Express, Inc. was added as a defendant in the matter of Yali Golan v. Marc Puleo (former President and Chairman of the Board of Directors of the Company), filed in the Circuit Court of the Eleventh Judicial Circuit in and for Miami-Dade County, Florida. On March 6, 2006, the Company filed a motion to dismiss all counts of the complaint against the Company and on March 30, 2007, the United States District Court for the Southern District of Florida granted the Company's motion to dismiss in its entirety.

The Company was a defendant in a multi-defendant lawsuit, filed in August 2006 in the United States District Court For The Eastern District of Texas, Marshall Division, seeking injunctive and monetary relief styled Ronald A. Katz Technology Licensing, L.P., v. Aetna Inc. et al., Cause No. 206CV 335. The lawsuit alleged that the Company was infringing on certain telephone call manipulation technology-related patents owned by the plaintiff. Without admitting any liability or wrongdoing, and with no finding or admission as to the merit or lack of merit of any claim or defense asserted in connection with the litigation, in

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January, 2007, the Company entered into a licensing agreement for a confidential amount, and a Stipulation of Dismissal with Prejudice was filed with the Court, dismissing the lawsuit against the Company.

### Routine Proceedings

The Company is a party to routine litigation and administrative complaints incidental to its business. Management does not believe that the resolution of any or all of such routine litigation and administrative complaints is likely to have a material adverse effect on the Company's financial condition or results of operations. The Company has settled complaints that had been filed with various states' pharmacy boards in the past. There can be no assurances made that other states will not attempt to take similar actions against the Company in the future. Legal costs related to the above matters are expensed as incurred.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of our stockholders during the fourth quarter of the fiscal year ended March 31, 2007.

10

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common shares are traded on the NASDAQ Global Select Market ("NASDAQ") under the symbol "PETS." The prices set forth below reflect the range of high and low closing sale prices per share in each of the quarters of fiscal 2007 and 2006 as reported by the NASDAQ. These prices represent quotations among dealers without adjustments for retail mark-ups, markdowns or commissions, and may not represent actual transactions.

Fiscal 2007:	High	Low
First Quarter	\$17.72	\$10.97
Second Quarter	\$13.08	\$9.44
Third Quarter	\$14.19	\$10.13
Fourth Quarter	\$14.17	\$11.74
Fiscal 2006:	High	Low
First Quarter	\$8.21	\$6.50

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Second Quarter	\$11.64	\$7.63
Third Quarter	\$15.52	\$9.83
Fourth Quarter	\$19.99	\$14.34

There were 86 holders of record of our common stock at May 31, 2007, and we estimate there were approximately 10,900 beneficial stockholders on that date.

### Dividend Policy

The Company has never paid cash dividends on our common stock. We presently intend to retain future earnings to finance the expansion of our business. Our future dividend policy will depend on our earnings, capital requirements, expansion plans, financial condition, and other relevant factors.

### Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth securities authorized for issuance under equity compensation plans, including individual compensation arrangements, by us under our 1998 Stock Option Plan, 2006 Employee Equity Compensation Restricted Stock Plan, and 2006 Outside Director Equity Compensation Restricted Stock Plan as of March 31, 2007:

#### EQUITY COMPENSATION PLAN INFORMATION

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securi remaining availa for future issua
	(a)	(b)	(c)
1998 Stock Option Plan	665,768	\$8.65	810,068
2006 Employee Restricted Stock Plan	136,625	-	863,375
2006 Director Restricted Stock Plan	20,000	-	180,000
	-----		-----
Total	822,393		1,853,443
	=====		=====

### Share Repurchase Plan

On November 8, 2006, the Company's Board of Directors approved a share repurchase plan of up to \$20 million. This plan is intended to be implemented through purchases made from time to time in either the open market or through private transactions at the Company's discretion, subject to market conditions and other factors, in accordance with Securities and Exchange Commission requirements. There can be no assurances as to the precise number of shares that will be repurchased under the share repurchase plan, and the Company may discontinue the share repurchase plan at any

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time subject to compliance with applicable regulatory requirements. Shares purchased pursuant to the share repurchase plan will either be cancelled or held in the Company's treasury. Any share repurchase would reduce our available cash. As of the date of this report no shares have been repurchased under this share repurchase plan.

11

### Performance Graph

Set forth below is a graph comparing the cumulative performance of our Common Stock with the Standard & Poor's Composite-500 Stock Index (the "S&P 500") and the Nasdaq Composite, from March 31, 2002 to March 31, 2007. The graph assumes that \$100 was invested on March 31, 2002 in each of our Common Stock, the S&P 500 and the Nasdaq Composite and that all dividends were reinvested.

[GRAPHIC OF GRAPH]

### Performance graph data:

	Fiscal Year Ended March 31,					
	2002	2003	2004	2005	2006	2007
Nasdaq Composite	100.00	72.68	108.07	108.34	126.79	131.23
S&P 500	100.00	73.92	98.15	102.89	112.85	123.83
PetMed Express, Inc.	100.00	295.00	1375.00	926.25	2221.25	1481.25

12

### ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data should be read together with "Management's Discussion and Analysis of Financial Condition and Results of Operations," the consolidated financial statements and notes thereto, and other financial information included elsewhere in this Annual Report on Form 10-K. The consolidated statements of income data set forth below for the fiscal years ended March 31, 2007, 2006, and 2005 and the consolidated balance sheet data as of March 31, 2007 and 2006 have been derived from our audited consolidated financial statements which are included elsewhere in this Annual Report on Form 10-K. The consolidated statements of income data set forth below for

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the fiscal years ended March 31, 2004 and 2003 and the consolidated balance sheet data as of March 31, 2005, 2004 and 2003 have been derived from our audited consolidated financial statements which are not included in this Annual Report on Form 10-K.

### STATEMENTS OF INCOME

	Fiscal Year Ended March 31,			
	2007	2006	2005	2004
Sales	\$ 162,246,407	\$ 137,583,155	\$ 108,357,747	\$ 93,994,233
Cost of sales	97,680,238	83,244,366	64,700,002	55,824,406
Gross profit	64,566,169	54,338,789	43,657,745	38,169,827
Operating expenses	43,066,144	36,193,545	31,156,119	28,958,433
Net income	14,443,502	12,063,514	8,010,370	5,813,604
Net income per common share:				
Basic	0.60	0.51	0.35	0.30
Diluted	0.60	0.50	0.34	0.25
Weighted average number of common shares outstanding:				
Basic	24,109,035	23,658,722	22,862,417	19,471,681
Diluted	24,270,879	24,211,955	23,833,189	23,689,866

### BALANCE SHEET DATA

	March 31,			
	2007	2006	2005	2004
Working capital	\$ 50,613,455	\$ 34,968,771	\$ 21,968,784	\$ 11,338,004
Total assets	61,218,487	42,624,159	28,119,483	18,480,808
Total liabilities	7,354,914	4,984,630	3,902,419	4,486,299
Shareholders' equity	53,863,573	37,639,529	24,217,064	13,994,509

### NON FINANCIAL DATA (UNAUDITED)

	March 31,			
	2007	2006	2005	2004
New customers acquired	681,000	624,000	510,000	572,000
Total accumulated customers (1)	3,136,000	2,455,000	1,831,000	1,321,000

(1) includes both active and inactive customers

#### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

##### Executive Summary

PetMed Express was incorporated in the state of Florida

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in January 1996. The Company's common stock is traded on the NASDAQ Global Select Market under the symbol "PETS." The Company began selling pet medications and other pet health products in September 1996, and issued its first catalog in the fall of 1997. This catalog displayed approximately 1,200 items, including prescription and non-prescription pet medications, other pet health products, and pet accessories. In fiscal 2001, the Company focused its product line on approximately 600 of the most popular pet medications and other health products for dogs and cats. Presently, the Company's product line includes approximately 750 of the most popular pet medications and other health products for dogs, cats, and horses.

The Company markets its products through national television, online, and direct mail/print advertising campaigns which direct consumers to order by phone or on the Internet, and aim to increase the recognition of the "1-800-PetMeds" brand name. Currently, approximately 62% of all sales are generated via the Internet compared to 57% last year.

The Company's sales consist of products sold mainly to retail consumers and minimally to wholesale customers. Typically, the Company's customers pay by credit card or check at the time the order is shipped. The Company usually receives cash settlement in two to three banking days for sales paid by credit cards, which minimizes the accounts receivable balances relative to the Company's sales. The Company's sales returns average was approximately 1.7 % and 1.5 % of sales for the fiscal years ended March 31, 2007 and 2006, respectively. The twelve-month average purchase was approximately \$79 and \$77 per order for the fiscal years ended March 31, 2007 and 2006, respectively.

### Critical Accounting Policies

Our discussion and analysis of our financial condition and the results of our operations are based upon our consolidated financial statements and the data used to prepare them. The Company's 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 judgments and estimates including those related to product returns, bad debts, inventories, long-lived assets, income taxes, litigation and contingencies. We base our estimates and judgments 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

The Company generates revenue by selling pet medication products primarily to retail consumers and minimally to wholesale customers. The Company's policy is to recognize revenue from product sales upon shipment, when the rights of ownership and risk of loss have passed to the customer. Outbound shipping and handling fees are included in sales

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and are billed upon shipment. Shipping expenses are included in cost of sales.

The majority of the Company's sales are paid by credit cards and the Company usually receives the cash settlement in two to three banking days. Credit card sales minimize accounts receivable balances relative to sales. The Company maintains an allowance for doubtful accounts for losses that the Company estimates will arise from the customers' inability to make required payments, arising from either credit card charge-backs or insufficient funds checks. The Company determines its estimates of the uncollectibility of accounts receivable by analyzing historical bad debts and current economic trends. At March 31, 2007 and 2006 the allowance for doubtful accounts was approximately \$28,000 and \$23,000, respectively.

### Valuation of inventory

Inventories consist of prescription and non-prescription pet medications and pet supplies that are available for sale and are priced at the lower of cost or market value using a weighted average cost method. The Company writes down its inventory for estimated obsolescence. The inventory reserve was approximately \$122,000 and \$306,000 for the fiscal years ended March 31, 2007 and 2006, respectively.

14

### 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 seven 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.

### 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 a 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, and direct mail/print advertising. Television costs are expensed as the advertisements are televised. Internet costs are

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expensed in the month incurred and direct mail/print advertising 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 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 differences are expected to reverse.

### Results of Operations

The following should be read in conjunction with the Company's Consolidated Financial Statements and the related notes thereto included elsewhere herein. The following table sets forth, as a percentage of sales, certain operating data appearing in the Company's Consolidated Statements of Income:

	Fiscal Year Ended March 31,		
	2007	2006	2005
	-----	-----	-----
Sales	100.0 %	100.0 %	100.0 %
Cost of sales	60.2	60.5	59.7
	-----	-----	-----
Gross profit	39.8	39.5	40.3
	-----	-----	-----
Operating expenses:			
General and administrative	10.6	10.2	10.6
Advertising	15.6	15.7	17.7
Depreciation and amortization	0.3	0.4	0.5
	-----	-----	-----
Total operating expenses	26.5	26.3	28.8
	-----	-----	-----
Income from operations	13.3	13.2	11.5
	-----	-----	-----
Total other income (expense)	1.0	0.7	0.1
	-----	-----	-----
Income before provision for income taxes	14.3	13.9	11.6
	-----	-----	-----
Provision for income taxes	5.4	5.1	4.2
	-----	-----	-----
Net income	8.9 %	8.8 %	7.4 %
	=====	=====	=====

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Fiscal 2007 Compared to Fiscal 2006

### Sales

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Sales increased \$24,663,000, or 17.9%, to \$162,246,000 for the year ended March 31, 2007, from \$137,583,000 for the fiscal year ended March 31, 2006. The increase in sales can be primarily attributed to increased retail reorders and new orders, offset by decreased wholesale sales, during the fiscal year.

The Company has committed certain amounts specifically designated towards television, direct mail/print and online advertising to stimulate sales, create brand awareness, and acquire new customers. Retail reorder sales have increased by approximately \$22,173,000, or 25.1%, to approximately \$110,540,000 for the fiscal year ended March 31, 2007, from approximately \$88,367,000 for the fiscal year ended March 31, 2006. Retail new order sales have increased by approximately \$5,608,000, or 12.3%, to approximately \$51,096,000 for the fiscal year ended March 31, 2007, from approximately \$45,488,000 for the fiscal year ended March 31, 2006. Wholesale sales have decreased by approximately \$3,118,000, or 83.6%, to approximately \$610,000 for the fiscal year ended March 31, 2007, from approximately \$3,728,000 for the fiscal year ended March 31, 2006. We limited our wholesale sales in fiscal 2007 and we may limit future wholesale sales to continue to focus our business on retail sales. The Company acquired approximately 681,000 new customers for the fiscal year ended March 31, 2007, compared to 624,000 new customers for the same period in the prior year. There can be no assurances that this growth trend will continue due to increased price competition from veterinarians and traditional and online retailers.

The majority of our product sales are affected by the seasons, due to the seasonality of mainly heartworm and flea and tick medications. For the quarters ended June 30, September 30, December 31, and March 31 of fiscal 2007, the Company's sales were approximately 31%, 27%, 19%, and 23%, respectively.

### Cost of sales

-----

Cost of sales increased by \$14,436,000, or 17.3%, to \$97,680,000 for the fiscal year ended March 31, 2007, from \$83,244,000 for the fiscal year ended March 31, 2006. The increase in cost of sales is directly related to the increase in retail sales in fiscal 2007 as compared to fiscal 2006. As a percent of sales, the cost of sales was 60.2% in fiscal 2007, as compared to 60.5% in fiscal 2006. The percentage decrease can be mainly attributed to a decrease in our wholesale sales, which had a higher cost of sales percentage, and due to a shift in our product mix to higher gross profit margin items, offset by additional price discounts given to customers.

### Gross profit

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 Gross profit increased by \$10,227,000, or 18.8%, to \$64,566,000 for the fiscal year ended March 31, 2007, from \$54,339,000 for the fiscal year ended March 31, 2006. Gross profit as a percentage of sales for fiscal 2007 and 2006 was 39.8% and 39.5%, respectively. The gross profit percentage increase can be mainly attributed to a decrease in our wholesale sales, which had a lower gross profit percentage, and due to a shift in our product mix to higher gross profit margin items, offset by additional price discounts given to customers.

General and administrative expenses  
 -----

General and administrative expenses increased by \$3,215,000, or 22.8%, to \$17,293,000 for the fiscal year ended March 31, 2007 from \$14,078,000 for the fiscal year ended March 31, 2006. General and administrative expenses as a percentage of sales was 10.6% compared to 10.2% for the fiscal years ended March 31, 2007 and 2006, respectively. The increase in general and administrative expenses for the fiscal year ended March 31, 2007 was primarily due to the following: a \$2,194,000 increase to payroll expenses, with \$893,000 of the increase due to the recognition of stock option compensation expense during the period relating to the implementation of SFAS 123R, "Share Based Payment," and the remaining increase attributed to the addition of new employees in the customer care and pharmacy departments enabling the Company to sustain its growth; a \$530,000 increase to credit card and bank service fees which is directly attributable to increased sales in the fiscal year; a \$260,000 increase to licenses and fees, the majority of the increase relating to the first time compliance with a California mill assessment fee on certain products sold in that state; a \$169,000 increase to property expenses relating to additional rent due to our warehouse expansion; a \$125,000 increase to office expenses which can be directly attributed to increased sales; a \$105,000 increase to telephone expenses resulting from receiving one-time usage credits during the prior fiscal year; a \$87,000 increase to insurance expenses, relating to an increase in premiums paid; and a \$36,000 increase to other expenses which includes bad debt and travel expenses. Offsetting the increase was a \$162,000 one-time charge, relating to state/county sales tax, which was not collected on behalf of customers, which was booked in the first quarter of fiscal 2006; and a \$129,000 decrease in professional fees, primarily relating to the reduction of legal fees and Sarbanes-Oxley compliance fees.

Advertising expenses  
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Advertising expenses increased by approximately \$3,672,000, or approximately 17.0%, to approximately

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\$25,243,000 for the fiscal year ended March 31, 2007 from approximately \$21,571,000 for the fiscal year ended March 31, 2006. The increase in advertising expenses for the fiscal year ended March 31, 2007 was due to the Company's plan to commit certain amounts specifically designated towards television, direct mail/print, and online advertising to stimulate sales, create brand awareness, and acquire new customers.

The advertising cost of acquiring a new customer, defined as total advertising cost divided by new customers acquired, for the fiscal year ended March 31, 2007 was \$37, compared to \$35 for the same period the prior year. Advertising cost of acquiring a new customer can be impacted by the advertising environment, the effectiveness of our advertising creative, increased advertising spending, and price competition from veterinarians and other retailers of pet medications. Historically, the advertising environment fluctuates due to supply and demand. A less favorable advertising environment may negatively impact future new order sales. As a percentage of sales, advertising expense was 15.6% in fiscal 2007, as compared to 15.7% in fiscal 2006. The Company currently anticipates advertising as a percentage of sales to range from approximately 14.0% to 16.0% in fiscal 2008. However, the advertising percentage will fluctuate quarter to quarter due to seasonality and advertising availability. For the fiscal year ended March 31, 2007, quarterly advertising expenses as a percentage of sales ranged between 12% and 18%.

### Depreciation and amortization

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Depreciation and amortization decreased by approximately \$15,000, or 2.6%, to approximately \$530,000 for the fiscal year ended March 31, 2007 from approximately \$545,000 for the fiscal year ended March 31, 2006. This decrease to depreciation and amortization expense for fiscal 2007 can be attributed to the fact that existing property and equipment items have been fully depreciated.

### Other income

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Other income increased by approximately \$811,000, or 91.1%, to approximately \$1,701,000 for the fiscal year ended March 31, 2007, from approximately \$890,000 for the fiscal year ended March 31, 2006. The increase to other income can be primarily attributed to increased interest income due to increases in the Company's cash balance, which is swept into an interest bearing overnight account, and a tax-free short term investment account. The increase can also be attributed to additional advertising revenue generated from our website. Interest income may decrease in future years if the Company utilizes its cash balances on its \$20,000,000 share repurchase plan or on its operating activities.

### Provision for income taxes

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For the fiscal years ended March 31, 2007 and 2006, the Company recorded an income tax provision for approximately

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\$8,757,000 and \$6,972,000, respectively, which resulted in an effective tax rate of 37.7% and 36.6%, respectively.

Net income

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Net income increased by approximately \$2,380,000, or 19.7%, to approximately \$14,444,000 for the fiscal year ended March 31, 2007 from approximately \$12,064,000 for the fiscal year ended March 31, 2006. The increase was mainly attributable to the Company's sales growth and profitable operations.

17

Fiscal 2006 Compared to Fiscal 2005

Sales

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Sales increased \$29,225,000, or 27.0%, to \$137,583,000 for the year ended March 31, 2006, from \$108,358,000 for the year ended March 31, 2005. The increase in sales can be primarily attributed to increased retail new orders, retail reorders and wholesale sales, during the fiscal year.

The Company has committed certain amounts specifically designated towards television, direct mail/print and online advertising to stimulate sales, create brand awareness, and acquire new customers. Retail reorder sales have increased by approximately \$19,648,000, or 28.6%, to approximately \$88,367,000 for the fiscal year ended March 31, 2006, from approximately \$68,719,000 for the fiscal year ended March 31, 2005. Retail new order sales have increased by approximately \$8,280,000, or 22.3%, to approximately \$45,488,000 for the fiscal year ended March 31, 2006, from approximately \$37,208,000 for the fiscal year ended March 31, 2005. Wholesale sales have increased by approximately \$1,297,000, or 53.4%, to approximately \$3,728,000 for the fiscal year ended March 31, 2006, from approximately \$2,431,000 for the fiscal year ended March 31, 2005. We may limit our wholesale sales in the future to focus our business on retail sales. The Company acquired approximately 624,000 new customers for the year ended March 31, 2006, compared to 510,000 new customers for the same period in the prior year. The increase in retail sales growth for fiscal 2006 compared to fiscal 2005 can be attributed to increased advertising effectiveness, due to a more favorable advertising environment, with more effective creative, and discount offers. There can be no assurances that this trend will continue due to increased price competition from veterinarians and traditional and online retailers.

The majority of our product sales are affected by the seasons, due to the seasonality of mainly heartworm and flea and tick medications. For the quarters ended June 30, September 30, December 31, and March 31 of fiscal 2006, the Company's sales were approximately 32%, 28%, 19%, and 21%,

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respectively.

### Cost of sales

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Cost of sales increased by \$18,544,000, or 28.7%, to \$83,244,000 for the fiscal year ended March 31, 2006, from \$64,700,000 for the fiscal year ended March 31, 2005. The increase in cost of sales is directly related to the increase in retail and wholesale sales in fiscal 2006 as compared to fiscal 2005. As a percent of sales, the cost of sales was 60.5% in fiscal 2006, as compared to 59.7% in fiscal 2005. The percentage increase can be attributed to increases in our product and freight costs, discounts given to our customers, and increases in our wholesale sales, which have a lower gross profit percentage.

### Gross profit

-----

Gross profit increased by \$10,681,000, or 24.5%, to \$54,339,000 for the fiscal year ended March 31, 2006, from \$43,658,000 for the fiscal year ended March 31, 2005. Gross profit as a percentage of sales for fiscal 2006 and 2005 was 39.5% and 40.3%, respectively. The gross profit percentage decrease can be attributed to increases in our product and freight costs, discounts given to our customers, and increases in our wholesale sales, which have a lower gross profit percentage.

### General and administrative expenses

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General and administrative expenses increased by \$2,682,000, or 23.5%, to \$14,078,000 for the fiscal year ended March 31, 2006 from \$11,396,000 for the fiscal year ended March 31, 2005. However, general and administrative expense as a percentage of sales was 10.2% compared to 10.6% for the fiscal years ended March 31, 2006 and 2005, respectively. The increase in general and administrative expenses for the year ended March 31, 2006 was primarily due to the following: a \$798,000 increase to payroll expenses which can be attributed to the addition of new employees in the customer care and pharmacy departments enabling the company to sustain its growth; a \$663,000 increase to professional fees, primarily relating to increased pharmacist, accounting, the majority relating to Sarbanes Oxley compliance, and legal fees; a \$646,000 increase to credit card and bank service fees which is directly attributable to increased sales in the period; a \$183,000 increase to property expenses, relating to unanticipated hurricane-related charges, mainly generator and fuel expenses, during the third quarter and additional rent due to our warehouse expansion; a \$162,000 one-time charge relating to state/county sales tax which was not collected on behalf of our customers; a \$110,000 increase to telephone expenses resulting from receiving one time usage credits in the quarters ended September 30, 2004 and December 31, 2004; a \$85,000 increase to office expenses which can be directly attributed to increased sales and unanticipated hurricane-related charges in the period; a \$36,000 increase to insurance expenses, relating to an increase in premiums

paid; and a \$1,000 decrease to other expenses.

18

Advertising expenses

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Advertising expenses increased by approximately \$2,385,000, or approximately 12.4%, to approximately \$21,571,000 for the fiscal year ended March 31, 2006 from approximately \$19,186,000 for the fiscal year ended March 31, 2005. The increase in advertising expenses for the fiscal year ended March 31, 2006 was due to the Company's plan to commit certain amounts specifically designated towards television, direct mail/print, and online advertising to stimulate sales, create brand awareness, and acquire new customers.

The advertising costs of acquiring a new customer, defined as total advertising costs divided by new customers acquired, for the fiscal year ended March 31, 2006 was \$35, compared to \$38 for the same period the prior year. We can attribute this reduction to an increase in advertising efficiency due to a more favorable advertising environment. There can be no assurances made that this favorable advertising environment will continue. Historically, the advertising environment fluctuates due to supply and demand. A less favorable advertising environment may negatively impact new order sales. As a percentage of sales, advertising expense was 15.7% in fiscal 2006, as compared to 17.7% in fiscal 2005. The Company currently anticipates advertising as a percentage of sales to range from approximately 15.0% to 16.0% in fiscal 2007. However, the advertising percentage will fluctuate quarter to quarter due to seasonality and advertising availability. For the year ended March 31, 2006, quarterly advertising expenses as a percentage of sales ranged between 12% and 18%.

Depreciation and amortization

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Depreciation and amortization decreased by approximately \$29,000, or 5.1%, to approximately \$545,000 for the fiscal year ended March 31, 2006 from approximately \$574,000 for the fiscal year ended March 31, 2005. This decrease to depreciation and amortization expense for fiscal 2006 can be attributed to decreased property and equipment additions since the first quarter of fiscal 2005.

Other income

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Other income increased by approximately \$788,000 to approximately \$890,000 for the fiscal year ended March 31, 2006, from approximately \$102,000 for the fiscal year ended March 31, 2005. The increase to other income can be primarily attributed to increased interest income due to increases in the Company's cash balance, which is swept into an interest bearing overnight account and tax-free short

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term investment account, and to advertising revenue generated from our website. Interest income may decrease in future years as the Company utilizes its cash balances on operating activities.

### Provision for income taxes

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For the fiscal years ended March 31, 2006 and 2005, the Company recorded an income tax provision for approximately \$6,972,000 and \$4,593,000, respectively, which resulted in an effective tax rate of 36.6% and 36.4%, respectively.

### Net income

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Net income increased by approximately \$4,054,000, or 50.6%, to approximately \$12,064,000 for the fiscal year ended March 31, 2006 from approximately \$8,010,000 for the fiscal year ended March 31, 2005. The significant increase was mainly attributable to the Company's sales growth and profitable operations and the leverage of general and administrative and advertising expenses.

### Liquidity and Capital Resources

The Company's working capital at March 31, 2007 and 2006 was \$50,613,000 and \$34,969,000, respectively. The \$15,644,000 increase in working capital was primarily attributable to cash flow generated from operations and the exercise of stock options. Net cash provided by operating activities was \$16,564,000 and \$10,277,000 for the fiscal years ended March 31, 2007 and 2006, respectively. Net cash used in investing activities was \$17,300,000 and \$11,808,000 for the fiscal years ended March 31, 2007 and 2006, respectively. This \$5,492,000 increase can be attributed to increased temporary investments and increased property and equipment additions to support the Company's growth, the addition of back-up infrastructure, the upgrade to its e-commerce platform, and the maintenance of existing assets in fiscal 2007. Net cash provided by financing activities was \$685,000 and \$1,016,000 for the fiscal years ended March 31, 2007 and 2006, respectively. This \$331,000 decrease can be attributed to a decrease in the number of stock options exercised in fiscal 2007 compared to fiscal 2006.

As of March 31, 2007 and 2006 the Company had no outstanding lease commitments except for the lease for its executive offices and warehouse. On May 18, 2005 the Company signed an amendment to extend the current lease agreement through May 31, 2009. The amendment terms are similar to the existing lease agreement, and the Company exercised its option to lease an additional 3,600 square feet. On November 28, 2005 the Company signed an amendment to its current lease agreement, to lease an additional 7,000 square feet to expand its warehouse and pharmacy. This addition to the warehouse and pharmacy was necessary to

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increase the Company's capacity to store additional inventory and expand its fulfillment operations. The Company had financed certain equipment acquisitions with capital leases.

Presently, the Company has approximately \$500,000 planned for capital expenditure commitments to further the Company's growth during fiscal 2008, which will be funded through cash from operations. The Company's source of working capital includes cash from operations and the exercise of stock options. The Company presently has no need for other alternative sources of working capital and at this time, has no commitments or plans to obtain additional capital. If in the future the Company seeks to raise additional capital 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. Further, there can be no assurances that even if such additional capital is obtained the Company will sustain profitability or positive cash flow.

### Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"), which provides criteria for the recognition, measurement, presentation, and disclosure of uncertain tax positions. A tax benefit from an uncertain position may be recognized only if it is "more likely than not" that the position is sustainable based on its technical merits. The provisions of FIN 48 were effective for the Company's fiscal year beginning April 1, 2007. We do not expect FIN 48 will have a material effect on our consolidated financial position, results of operations, or cash flows.

In June 2006, the FASB's Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That Is, Gross versus Net Presentation)." The scope of EITF 06-3 includes sales, use, value added, and some excise taxes that are assessed by a governmental authority on specific revenue-producing transactions between a seller and customer. EITF 06-3 requires disclosure of the method of accounting for the applicable assessed taxes and the amount of assessed taxes that are included in revenues if they are accounted for under the gross method. EITF 06-3 is effective for the Company's fiscal year beginning April 1, 2007. EITF 06-3 will not impact the method for recording these taxes in the Company's consolidated financial statements as the Company historically has presented sales excluding these taxes.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 provides guidance on the consideration of effects of the prior year misstatements in quantifying

current year misstatements for the purpose of a materiality assessment. The SEC staff believes registrants must quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for the first annual period ending after November 15, 2006 with early application encouraged. The Company adopted SAB 108 in fiscal 2007.

The Company does not believe that any other recently issued, but not yet effective, accounting standards, if currently adopted, will have a material effect on the Company's consolidated financial position, results of operations or cash flows.

20

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk generally represents the risk that losses may occur in the value of financial instruments as a result of movements in interest rates, foreign currency exchange rates, and commodity prices. Our financial instruments include cash and cash equivalents, temporary investments, accounts receivable, accounts payable, line of credit, and debt obligations. The book values of cash equivalents, temporary investments, accounts receivable, and accounts payable are considered to be representative of fair value because of the short maturity of these instruments. At March 31, 2007, we had no debt obligations.

We do not utilize financial instruments for trading purposes and we do not hold any derivative financial instruments that could expose us to significant market risk. The Company has no material exposure to market risk for changes in interest rates.

The above sensitivity analysis for interest rate risk excludes accounts receivable, accounts payable, and accrued liabilities because of the short-term maturity of such instruments. The analysis does not consider the effect this movement may have on other variables including changes in revenue volumes that could be indirectly attributed to changes in interest rates. The actions that management would take in response to such a change are also not considered. If it were possible to quantify this impact, the results could well be different than the sensitivity effects shown above.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

PETMED EXPRESS, INC. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
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Report of Independent Registered Public Accounting Firm	23
Consolidated Balance Sheets as of March 31, 2007 and March 31, 2006	24
Consolidated Statements of Income for each of the three years in the period ended March 31, 2007	25
Consolidated Statements of Changes in Shareholders' Equity for each of the three years in the period ended March 31, 2007	26
Consolidated Statements of Cash Flows for each of the three years in the period ended March 31, 2007	27
Notes to Consolidated Financial Statements	28
Report of Management on Internal Control Over Financial Reporting	39
Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting	40

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders  
PetMed Express, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets  
of PetMed Express, Inc. and Subsidiaries (the "Company") as  
of March 31, 2007 and 2006, and the related consolidated

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statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended March 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of PetMed Express, Inc. and Subsidiaries as of March 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for share-based compensation effective April 1, 2006.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of March 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated May 31, 2007 expressed an unqualified opinion thereon.

/s/ Goldstein Golub Kessler LLP

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Goldstein Golub Kessler LLP

New York, New York  
May 31, 2007

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## CONSOLIDATED BALANCE SHEETS

	March 31,	
	2007	2006
ASSETS		
-----		
Current assets:		
Cash and cash equivalents	\$ 316,470	\$ 366,9
Temporary investments	39,125,000	22,850,0
Accounts receivable, less allowance for doubtful accounts of \$28,000 and \$23,000, respectively	1,369,521	1,155,7
Inventories - finished goods	16,086,207	14,997,6
Prepaid expenses and other current assets	1,071,171	583,0
	57,968,369	39,953,4
Total current assets		
Property and equipment, net	1,990,578	1,497,5
Deferred income taxes	894,540	794,0
Intangible asset	365,000	365,0
Other assets	-	14,1
	\$ 61,218,487	\$ 42,624,1
Total assets	\$ 61,218,487	\$ 42,624,1
LIABILITIES AND SHAREHOLDERS' EQUITY		
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Current liabilities:		
Accounts payable	\$ 5,859,756	\$ 3,052,9
Income taxes payable	229,321	958,3
Accrued expenses and other current liabilities	1,265,837	973,3
	7,354,914	4,984,6
Total liabilities		
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	8,8
Common stock, \$.001 par value, 40,000,000 shares authorized; 24,309,417 and 23,967,390 shares issued and outstanding, respectively	24,309	23,9
Additional paid-in capital	15,213,254	13,433,0
Retained earnings	38,617,112	24,173,6
	53,863,573	37,639,5
Total shareholders' equity		
Total liabilities and shareholders' equity	\$ 61,218,487	\$ 42,624,1
	\$ 61,218,487	\$ 42,624,1

See accompanying notes to consolidated financial statements.

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PETMED EXPRESS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended March 31,		
	2007	2006	2005
Sales	\$ 162,246,407	\$ 137,583,155	\$ 108,357,000
Cost of sales	97,680,238	83,244,366	64,700,000
Gross profit	64,566,169	54,338,789	43,657,000
Operating expenses:			
General and administrative	17,292,675	14,078,343	11,396,000
Advertising	25,243,029	21,570,667	19,185,000
Depreciation and amortization	530,440	544,535	573,000
Total operating expenses	43,066,144	36,193,545	31,156,000
Income from operations	21,500,025	18,145,244	12,501,000
Other income (expense):			
Interest income, net	1,266,150	676,083	98,000
Other, net	435,824	215,586	3,000
Loss on disposal of property and equipment	(1,250)	(1,719)	
Total other income (expense)	1,700,724	889,950	101,000
Income before provision for income taxes	23,200,749	19,035,194	12,603,000
Provision for income taxes	8,757,247	6,971,680	4,593,000
Net income	\$ 14,443,502	\$ 12,063,514	\$ 8,010,000
Net income per common share:			
Basic	\$ 0.60	\$ 0.51	\$ 0.00
Diluted	\$ 0.60	\$ 0.50	\$ 0.00
Weighted average number of common shares outstanding:			
Basic	24,109,035	23,658,722	22,862,000
Diluted	24,270,879	24,211,955	23,833,000

See accompanying notes to consolidated financial statements.

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### PETMED EXPRESS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Fiscal years ended March 31, 2005, March 31, 2006 and March 31, 2007

	Convertible Preferred Stock		Common Stock		Additional Paid-In
	Shares	Amounts	Shares	Amounts	Capital
Balance, March 31, 2004	2,500	\$ 8,898	21,860,057	\$ 21,860	\$ 9,864,025
Issuance of common stock from exercise of stock options	-	-	1,058,668	1,059	1,076,130
Issuance of common stock from exercise of warrants and other	-	-	540,000	540	215,707
Tax benefit related to stock options exercised	-	-	-	-	918,749
Net income	-	-	-	-	-
Balance, March 31, 2005	2,500	\$ 8,898	23,458,725	\$ 23,459	\$ 12,074,611
Issuance of common stock from exercise of stock options	-	-	508,665	508	1,015,523
Tax benefit related to stock options exercised	-	-	-	-	342,920
Net income	-	-	-	-	-
Balance, March 31, 2006	2,500	\$ 8,898	23,967,390	\$ 23,967	\$ 13,433,054
Issuance of common stock from exercise of stock options	-	-	185,402	185	441,899
Issuance of restricted stock	-	-	156,625	157	(157)
Share based compensation	-	-	-	-	1,095,740
Tax benefit related to stock options exercised	-	-	-	-	242,718
Net income	-	-	-	-	-
Balance, March 31, 2007	2,500	\$ 8,898	24,309,417	\$ 24,309	\$ 15,213,254

See accompanying notes to consolidated financial statements.

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### PETMED EXPRESS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended March 31,		
	2007	2006	2005
Cash flows from operating activities:			
Net income	\$ 14,443,502	\$ 12,063,514	\$ 8,000,000
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	530,440	544,535	570,000
Share based compensation	1,095,740	-	-
Tax benefit related to stock options exercised	-	342,920	91,000
Deferred income taxes	(100,538)	(211,156)	(100,000)
Loss on disposal of property and equipment	1,250	1,719	-
Bad debt expense (recovery)	29,554	(1,709)	1,000
(Increase) decrease in operating assets and increase (decrease) in liabilities:			
Accounts receivable	(243,294)	642,684	(67,000)
Inventories - finished goods	(1,088,532)	(3,817,342)	(1,000,000)
Prepaid expenses and other current assets	(488,133)	(369,886)	1,000
Other assets	14,167	-	-
Accounts payable	2,806,803	327,963	(54,000)
Income taxes payable	(728,997)	356,783	17,000
Accrued expenses and other current liabilities	292,478	397,465	(14,000)
Net cash provided by operating activities	16,564,440	10,277,490	8,340,000
Cash flows from investing activities:			
Net change in temporary investments	(16,275,000)	(11,050,000)	(11,800,000)
Purchases of property and equipment	(1,025,079)	(758,176)	(170,000)
Net proceeds from the sale of property and equipment	400	600	-
Net cash used in investing activities	(17,299,679)	(11,807,576)	(11,970,000)
Cash flows from financing activities:			
Proceeds from the exercise of stock options and warrants and other transactions	442,084	1,016,031	1,290,000
Tax benefit related to stock options exercised	242,718	-	-
Payments on the loan obligation	-	-	(60,000)
Net cash provided by financing activities	684,802	1,016,031	1,230,000
Net decrease in cash and cash equivalents	(50,437)	(514,055)	(2,390,000)
Cash and cash equivalents, at beginning of the year	366,907	880,962	3,270,000
Cash and cash equivalents, at end of year	\$ 316,470	\$ 366,907	\$ 880,000
Supplemental disclosure of cash flow information:			
Cash paid for interest	\$ -	\$ -	\$ -
Cash paid for income taxes	\$ 9,344,063	\$ 6,483,132	\$ 3,490,000

See accompanying notes to consolidated financial statements.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (1) Summary of Significant Accounting Policies

#### Organization

PetMed Express, Inc. and subsidiaries, d/b/a 1-800-PetMeds, (the "Company") is a leading nationwide pet pharmacy. The Company markets and sells prescription and non-prescription pet medications and other health products for dogs, cats, and horses direct to the consumer.

The Company markets its products through national television, online and direct mail/print advertising campaigns, which aim to increase the recognition of the "1-800-PetMeds" brand name, increase traffic on its website at [www.1800petmeds.com](http://www.1800petmeds.com), acquire new customers,

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and maximize repeat purchases. The majority of all of the Company's sales are to residents in the United States. The Company's executive offices are located in Pompano Beach, Florida. The Company's fiscal year end is March 31. References herein to fiscal 2007, 2006, or 2005 refer to the Company's fiscal years ended March 31, 2007, 2006 and 2005, respectively.

#### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its two wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

#### Revenue Recognition

The Company generates revenue by selling pet medication products primarily to retail consumers and minimally to wholesale customers. The Company's policy is to recognize revenue from product sales upon shipment, when the rights of ownership and risk of loss have passed to the consumer. Outbound shipping and handling fees are included in sales and are billed upon shipment. Shipping expenses are included in cost of sales.

The majority of the Company's sales are paid by credit cards and the Company usually receives the cash settlement in two to three banking days. Credit card sales minimize the accounts receivable balances relative to sales. The Company maintains an allowance for doubtful accounts for losses that the Company estimates will arise from the customers' inability to make required payments, arising from either credit card charge-backs or insufficient funds checks. The Company determines its estimates of the uncollectibility of accounts receivable by analyzing historical bad debts and current economic trends. At March 31, 2007 and 2006, the allowance for doubtful accounts was approximately \$28,000 and \$23,000, respectively.

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents at March 31, 2007 and 2006, consisted of the Company's cash accounts, overnight repurchase agreements, and short-term investments with a maturity of three months or less. The carrying amount of cash equivalents approximates fair value. The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Temporary Investments

The Company has reclassified its auction rate securities ("ARS") from cash and cash equivalents to temporary investments on its balance sheet in accordance with recent accounting pronouncements. This reclassification affected both the balance sheet in fiscal 2006 and 2007 and cash flow statement in fiscal 2005, 2006, and 2007, it did not affect net income or working capital in fiscal 2005, 2006, or 2007. In accordance with Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," no changes to financial statements issued in prior years were deemed necessary. In accordance with the Statement of Financial Accounting Standards ("SFAS") No. 115, Accounting for Certain Investments in Debt and Equity Securities, temporary investments are accounted for as trading securities. Trading securities are securities that are bought and held principally for the purpose of selling in the near term. The Company has not changed its investment policy. The Company believes that notwithstanding the reclassification, the investments in ARS are: short term and highly liquid, readily convertible to known amounts of cash, and present an insignificant risk of change in value due to market changes in interest rates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- (1) Summary of Significant Accounting Policies (Continued)

Use of Estimates

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

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the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Inventories

Inventories consist of prescription and non-prescription pet medications and pet supplies that are available for sale and are priced at the lower of cost or market value using a weighted average cost method. The Company writes down its inventory for estimated obsolescence. The inventory reserve was approximately \$122,000 and \$306,000 at March 31, 2007 and 2006, respectively.

### 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 seven 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.

### 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 a comparison of the carrying amount of the asset to net future cash flows expected to be generated from the asset.

### Intangible Asset

The intangible asset consists of a toll-free telephone number. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, the intangible asset is not being amortized, and is subject to an annual review for impairment.

### Advertising

The Company's advertising expenses consists primarily of television advertising, internet marketing, and direct mail/print advertising. Television costs are expensed as the advertisements are televised. Internet costs are expensed in the month incurred and direct mail/print advertising costs are expensed when the related catalog and postcards are produced, distributed, or superseded.

### Fair Value of Financial Instruments

The carrying amounts of the Company's cash and cash equivalents, temporary investments, accounts receivable, and accounts payable approximate fair value due to the short-term nature of these instruments.

Comprehensive Income

The Company applies SFAS No. 130, Reporting Comprehensive Income, which requires that all items that are recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The items of other comprehensive income that are typically required to be displayed are foreign currency items, minimum pension liability adjustments, and unrealized gains and losses on certain investments in debt and equity securities. There were no items of other comprehensive income for any periods presented herein.

29

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies (Continued)

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 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 differences are expected to reverse.

Accounting for Share Based Compensation

Stock Options

Effective April 1, 2006, the Company began recording compensation expense associated with stock options in accordance with SFAS No. 123R, "Share Based Payment," which is a revision of SFAS No. 123. Prior to April 1, 2006, the Company accounted for stock-based compensation related to stock options under the recognition and measurement principles of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees." At that time the Company measured compensation expense for its stock option plans using the intrinsic value method, that is, as the excess, if any, of the fair market value of the Company's stock at the grant date over the amount required to be paid to acquire the stock, and provided the disclosures required by SFAS Nos. 123 and 148. The Company has adopted the modified prospective transition method provided under SFAS No. 123R, and as a result,

has not retroactively adjusted results from prior periods. Under this transition method, compensation expense associated with stock options recognized in the first quarter of fiscal year 2007, and in subsequent quarters, includes: 1) expense related to the remaining unvested portion of all stock option awards granted prior to April 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123; and 2) expense related to all stock option awards granted, or modified, subsequent to April 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R.

As a result of the adoption of SFAS No. 123R, the Company's net income for the year ended March 31, 2007 includes \$893,000 of compensation expense. The compensation expense related to all of the Company's stock-based compensation arrangements is recorded as a component of general and administrative expenses.

For stock options granted prior to April 1, 2006, the estimated fair value of each option award granted was determined on the date of grant using the Black-Scholes option valuation model. For stock option grants on and after April 1, 2006, the estimated fair value of each option award granted will be determined on the date of grant using the Black-Scholes option-pricing model or a lattice-based option valuation model. The per share weighted-average fair value of stock options granted during fiscal 2006 and 2005 was \$3.51 and \$5.45, respectively, on the date of grant using the Black-Scholes option-pricing model, as prescribed by SFAS No. 123, with the following weighted-average assumptions: no dividend yield; risk-free interest rates ranging from 4 to 6 percent; expected lives of 3-5 years, and expected volatility of 66 percent and 86 percent, respectively. The risk-free interest rates for fiscal 2006 and 2005 were based on the prime interest rate at the date of grant. The expected volatility was based on the historical volatility of the Company's stock. No assumptions were necessary for fiscal 2007, due to the fact that no stock options were granted during the year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies (Continued)

The following table illustrates the pro forma effect on net income and earnings per common share as if the Company has applied the fair value recognition provisions of SFAS No. 123, as amended by SFAS No. 148,

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and related interpretations in accounting for its stock options in determining stock-based compensation for awards under the plan:

Year Ended March 31,	2006	2005
Reported net income:	\$ 12,063,514	\$ 8,010,370
Deduct: total stock-based employee compensation expense determined under fair-value based method for all awards, net of related tax effects	596,434	501,244
Pro forma net income:	\$ 11,467,080	\$ 7,509,126
Reported basic net income per share:	\$ 0.51	\$ 0.35
Pro forma basic net income per share:	\$ 0.48	\$ 0.33
Reported diluted net income per share:	\$ 0.50	\$ 0.34
Pro forma diluted net income per share:	\$ 0.48	\$ 0.32

### Restricted Stock

On July 28, 2006, the Company received shareholder approval for the adoption of the 2006 Employee Equity Compensation Restricted Stock Plan (the "Employee Plan") and the 2006 Outside Director Equity Compensation Restricted Stock Plan (the "Director Plan"). The purpose of the plans is to promote the interests of the Company by securing and retaining both employees and outside directors. The Company has reserved 1,000,000 shares of common stock for issuance under the Employee Plan. The Company has reserved 200,000 shares of common stock for issuance under the Director Plan. The value of the restricted stock is determined based on the market value of the common stock at the issuance date. The restriction period or forfeiture period is determined by the Company's Board, to be no less than 1 year and no more than ten years. The Company had 136,625 restricted common shares issued under the Employee Plan and 20,000 restricted common shares issued under the Director Plan at March 31, 2007, the fair value of which is being amortized over a three-year period. For the year ended March 31, 2007 the Company recognized \$203,000 of compensation expense related to the Employee and Director Plans. The compensation expense related to all of the Company's stock-based compensation arrangements is recorded as a

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component of general and administrative expenses. At March 31, 2007, there was \$1,668,000 of unrecognized compensation cost related to the non-vested restricted stock awards, which is expected to be recognized over the remaining weighted average vesting period of 2.70 years.

### Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"), which provides criteria for the recognition, measurement, presentation, and disclosure of uncertain tax positions. A tax benefit from an uncertain position may be recognized only if it is "more likely than not" that the position is sustainable based on its technical merits. The provisions of FIN 48 were effective for the Company's fiscal year beginning April 1, 2007. We do not expect FIN 48 will have a material effect on our consolidated financial position, results of operations or cash flows.

31

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### (1) Summary of Significant Accounting Policies (Continued)

In June 2006, the FASB's Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That Is, Gross versus Net Presentation)." The scope of EITF 06-3 includes sales, use, value added, and some excise taxes that are assessed by a governmental authority on specific revenue-producing transactions between a seller and customer. EITF 06-3 requires disclosure of the method of accounting for the applicable assessed taxes and the amount of assessed taxes that are included in revenues if they are accounted for under the gross method. EITF 06-3 is effective for the Company's fiscal year beginning April 1, 2007. EITF 06-3 will not impact the method for recording these taxes in the Company's consolidated financial statements as the Company historically has presented sales excluding these taxes.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 provides guidance on the consideration of effects of the prior year misstatements in quantifying current year misstatements

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for the purpose of a materiality assessment. The SEC staff believes registrants must quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for the first annual period ending after November 15, 2006 with early application encouraged. The Company adopted SAB 108 in fiscal 2007.

The Company does not believe that any other recently issued, but not yet effective, accounting standards, if currently adopted, will have a material effect on the Company's consolidated financial position, results of operations or cash flows.

### (2) Temporary Investments

The following is a summary of trading securities:

	March 31,	
	2007	2006
Trading Securities	\$ 39,125,000	\$ 22,850,000
Total temporary investments	\$ 39,125,000	\$ 22,850,000

### (3) Property and Equipment

Major classifications of property and equipment consist of the following:

	March 31,	
	2007	2006
Leasehold improvements	\$ 428,768	\$ 409,164
Computer software	945,356	427,447
Furniture, fixtures and equipment	2,942,461	2,456,695
	4,316,585	3,293,306
Less: accumulated depreciation and amortization	(2,326,007)	(1,795,717)
Property and equipment, net	\$ 1,990,578	\$ 1,497,589

32

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (4) Accrued Expenses and Other Liabilities

Major classifications of accrued expenses and other liabilities consist of the following:

	March 31,	
	2007	2006
	-----	-----

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Accrued credit card fees	\$ 285,972	\$ 232,022
Accrued salaries and benefits	266,002	170,846
Accrued professional expenses	212,500	300,500
Accrued advertising expenses	173,000	99,000
Other accrued liabilities	328,363	170,991
	-----	-----
Accrued expenses and other liabilities	\$ 1,265,837	\$ 973,359
	=====	=====

### (5) Shareholders' Equity

#### Preferred Stock

In April 1998, the Company issued 250,000 shares of its \$.001 par value preferred stock at a price of \$4.00 per share, less issuance costs of \$112,187. Each share of the preferred stock is convertible into approximately 4.05 shares of common stock at the election of the shareholder. The shares have a liquidation value of \$4.00 per share and may pay dividends at the sole discretion of the Company. The Company does not anticipate paying dividends to the preferred shareholders in the foreseeable future. Each share of preferred stock is entitled to one vote on all matters submitted to a vote of shareholders of the Company. As of March 31, 2007 and 2006, 2,500 shares of the convertible preferred stock remained unconverted and outstanding.

### (6) Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities are as follows:

	March 31,	
	2007	2006
	-----	-----
Deferred tax assets:		
Bad debt and inventory reserves	\$ 57,779	\$ 123,991
Accrued expenses	227,841	233,644
Deferred stock compensation	154,951	-
Net operating loss carryforward	1,065,092	1,139,232
	-----	-----
Deferred tax assets	1,505,663	1,496,867
Less: valuation allowance	(551,340)	(638,066)
	-----	-----
Total deferred tax assets	954,323	858,801
Deferred tax liabilities:		

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Depreciation	(59,783)	(64,799)
	-----	-----
Total net deferred taxes	\$ 894,540	\$ 794,002
	=====	=====

The change in the valuation allowance for the years ended March 31, 2007 and 2006 was approximately \$87,000 and \$79,000, respectively. At March 31, 2007, the Company had net operating loss carryforwards of approximately \$2,761,093. The net operating loss carryforwards expire in the years 2013 through 2020. The use of such net operating loss carryforwards is limited to approximately \$266,000 annually due to a change of control on November 22, 2000.

33

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(6) Income Taxes (Continued)

The components of the income tax provision consist of the following:

	Year Ended March 31,		
	2007	2006	2005
	-----	-----	-----
Current taxes			
Federal	\$ 7,594,848	\$ 6,114,087	\$ 3,911,564
State	1,262,937	1,046,607	682,971
	-----	-----	-----
Total current taxes	8,857,785	7,160,694	4,594,535
	-----	-----	-----
Deferred taxes			
Federal	(86,204)	(161,388)	(1,490)
State	(14,334)	(27,626)	-
	-----	-----	-----
Total deferred taxes	(100,538)	(189,014)	(1,490)
	-----	-----	-----
Total provision for income taxes	\$ 8,757,247	\$ 6,971,680	\$ 4,593,045
	=====	=====	=====

The reconciliation of income tax provision computed at the U.S. federal statutory tax rates to income tax expense is as follows:

	Year Ended March 31,		
	2007	2006	2005
	-----	-----	-----

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Income taxes at U.S. statutory rates	\$ 8,120,262	\$ 6,471,966	\$ 4,285,161
State income taxes, net of federal tax benefit	829,427	690,978	457,504
Permanent differences	(226,620)	(186,470)	9,178
Other	120,904	74,689	(72,445)
Change in valuation allowance	(86,726)	(79,483)	(86,353)
	-----	-----	-----
Total provision for income taxes	\$ 8,757,247	\$ 6,971,680	\$ 4,593,045
	=====	=====	=====

(7) Stock Options and Warrants

Stock Options Granted to Employees

The Company established the 1998 Stock Option Plan (the "Plan") effective July 31, 1998, which provides for the issuance of qualified options to officers and key employees, and nonqualified options to directors, consultants and other service providers. The Company has reserved 5,000,000 shares of common stock for issuance under the Plan. The exercise prices of options issued under the Plan must be equal to or greater than the market price of the Company's common stock as of the date of issuance. The Company had 665,768 and 851,170 options outstanding under the Plan at March 31, 2007 and 2006, respectively. Options generally vest ratably over a three-year period commencing on the first anniversary of the grant with respect to options granted to employees under the Plan. The 1998 Plan expires on July 31, 2008. In addition the Company issued options prior to July 31, 1998, which are not included in the Plan.

34

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(7) Stock Options and Warrants (Continued)

A summary of the status of the Company's stock option plan as of March 31, 2007 is as follows:

Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
------------------	---	---	---------------------------

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Options outstanding at March 31, 2006	851,170	\$ 7.28		
Options granted	-	-		
Options exercised	(185,402)	2.38		
Options forfeited or expired	-	-		
Options outstanding at March 31, 2007	665,768	\$ 8.65	2.40	\$ 5,758,43
Options vested and exercisable at March 31, 2007	464,934	\$ 9.25	1.92	\$ 4,298,44

Cash received from stock options exercised for fiscal 2007 and 2006 was \$442,000 and \$1,016,000, respectively. The income tax benefit from stock options exercised totaled \$243,000 and \$343,000 for the years ended March 31, 2007 and 2006, respectively. At March 31, 2007 and 2006, the number of options exercisable was 464,934 and 390,834, respectively, and the weighted-average exercise price of those options was \$9.25 and \$6.67, respectively. Adjustments were made for options forfeited prior to vesting.

A summary of the status of the Company's non-vested shares as of March 31, 2007 is presented below:

	Number of Shares	Weighted- Average Exercise Price per Share	Weighted- Average Remaining Contractual Term (years)
Non-vested shares at March 31, 2006	460,336	\$ 7.81	
Options granted	-	-	
Options vested	(259,502)	8.22	
Options forfeited or expired	-	-	
Non-vested shares at March 31, 2007	200,834	\$ 7.27	3.52

As of March 31, 2007, there was \$1,065,000 of unrecognized compensation cost related to non-vested stock option awards, which is expected to be recognized over a remaining weighted average vesting period of 2.25 years.

Warrants

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On November 22, 2000, Tricon Holdings, LLC, a Florida limited liability corporation ("Tricon"), acquired 10,000,000 shares of the Company's authorized and unissued shares of common stock and warrants to purchase 3,000,000 shares of the Company's authorized and unissued shares of common stock. The warrants were exercisable at \$.33 per share and were assigned a value of \$601,260 using the Black-Scholes option-pricing model, with the following weighted-average assumptions: dividend yield of 0.0 percent; risk-free interest rates of 6.00 percent; expected lives of 3-5 years, and expected volatility of 91 percent. As of March 31, 2005 all of the 3,000,000 warrants issued on November 22, 2000 were exercised.

35

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(8) Net Income Per Share

In accordance with the provisions of SFAS No. 128, "Earnings Per Share," basic net income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income per common share includes the dilutive effect of potential stock options exercised and the effects of the potential conversion of preferred shares, calculated using the treasury stock method. Outstanding stock options and convertible preferred shares issued by the Company represent the only dilutive effect reflected in diluted weighted average shares outstanding. The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the periods presented:

	2007	Year Ended March 31,	
		2006	2005
	-----	-----	-----
Net income (numerator):			
Net income	\$ 14,443,502	\$ 12,063,514	\$ 8,010,370
	=====	=====	=====
Shares (denominator)			
Weighted average number of common shares outstanding used in basic computation	24,109,035	23,658,722	22,862,417
Common shares issuable upon exercise of stock options and warrants	151,719	543,108	960,647
Common shares issuable upon conversion of preferred shares	10,125	10,125	10,125
	-----	-----	-----
Shares used in diluted computation	24,270,879	24,211,955	23,833,189
	=====	=====	=====

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Net income per common share:

Basic	\$	0.60	\$	0.51	\$	0.35
		=====		=====		=====
Diluted	\$	0.60	\$	0.50	\$	0.34
		=====		=====		=====

At March 31, 2007 and 2006, all common stock options were included in the diluted net income per common share computation as their exercise prices were less than the average market price of the common shares for the period. At March 31, 2005, 485,500 common stock options, with a weighted average exercise price of \$9.69, were excluded from the diluted net income per share computation as their exercise prices were greater than the average market price of the common shares for the period, therefore the effect would have been anti-dilutive.

### (9) Valuation and Qualifying Accounts

Activity in the Company's valuation and qualifying accounts consists of the following:

	Year Ended March 31,		
	2007	2006	2005
	-----	-----	-----
Allowance for doubtful accounts:			
Balance at beginning of period	\$ 23,426	\$ 36,535	\$ 22,987
Provision (recovery) for doubtful accounts	29,554	(1,709)	16,092
Write-off of uncollectible accounts receivable	(25,253)	(11,400)	(2,544)
	-----	-----	-----
Balance at end of period	\$ 27,727	\$ 23,426	\$ 36,535
	=====	=====	=====
Valuation allowance for deferred tax assets:			
Balance at beginning of period	\$ 638,066	\$ 717,549	\$ 803,902
(Deletions) / additions	(86,726)	(79,483)	(86,353)
	-----	-----	-----
Balance at end of period \$	551,340	\$ 638,066	\$ 717,549
	=====	=====	=====

36

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### (10) Commitments and Contingencies

##### Legal Matters

On January 19, 2006, PetMed Express, Inc. was added as a defendant in the matter of Yali Golan v. Marc Puleo

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(former President and Chairman of the Board of Directors of the Company), filed in the Circuit Court of the Eleventh Judicial Circuit in and for Miami-Dade County, Florida. On March 6, 2006, the Company filed a motion to dismiss all counts of the complaint against the Company and on March 30, 2007, the United States District Court for the Southern District of Florida granted the Company's motion to dismiss in its entirety.

The Company was a defendant in a multi-defendant lawsuit, filed in August 2006 in the United States District Court For The Eastern District of Texas, Marshall Division, seeking injunctive and monetary relief styled Ronald A. Katz Technology Licensing, L.P., v. Aetna Inc. et al., Cause No. 206CV 335. The lawsuit alleged that the Company was infringing on certain telephone call manipulation technology-related patents owned by the plaintiff. Without admitting any liability or wrongdoing, and with no finding or admission as to the merit or lack of merit of any claim or defense asserted in connection with the litigation, in January, 2007, the Company entered into a licensing agreement for a confidential amount, and a Stipulation of Dismissal with Prejudice was filed with the Court, dismissing the lawsuit against the Company.

### Routine Proceedings

The Company is a party to routine litigation and administrative complaints incidental to its business. Management does not believe that the resolution of any or all of such routine litigation and administrative complaints is likely to have a material adverse effect on the Company's financial condition or results of operations. The Company has settled complaints that had been filed with various states' pharmacy boards in the past. There can be no assurances made that other states will not attempt to take similar actions against the Company in the future. Legal costs related to the above matters are expensed as incurred.

### Employment Agreements

On March 16, 2001, the Company entered into an Executive Employment Agreement with its Chief Executive Officer ("CEO") and President, Menderes Akdag ("Mr. Akdag"). Under the terms of this three-year agreement the Company paid the CEO an annual salary of \$150,000 for the first six months of the agreement, and thereafter his annual salary was increased to \$200,000. The Company also granted the CEO options to purchase 750,000 shares of its common stock under the Company's 1998 Stock Option Plan at an exercise price of \$.32 per share, which vested at the rate of 187,500 options on each of March 16, 2001, 2002, 2003 and 2004.

On March 16, 2004, the Company amended the CEO's existing Executive Employment Agreement. The amendments were as follows: the term of the agreement was for three years, commencing on March 16, 2004; Mr. Akdag's salary was increased to \$250,000 per year

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throughout the term of the agreement, and Mr. Akdag was granted 250,000 incentive stock options under the Company's 1998 Stock Option Plan at an exercise price of \$10.64 per share, which vested at the rate of 83,333 options on each of March 16, 2005 and 2006, and 83,334 options on March 16, 2007.

On February 27, 2007, the Company amended the CEO's existing Executive Employment Agreement and entered into Amendment No. 2 to the Executive Employment Agreement ("Agreement") with Mr. Akdag. The Agreement amended certain provisions of the Executive Employment Agreement as follows: the term of the Agreement will be for three years, commencing on March 16, 2007; Mr. Akdag's salary will be increased to \$450,000 per year throughout the term of the Agreement, and Mr. Akdag shall be granted 90,000 shares of restricted stock. The restricted stock was granted on February 27, 2007, in accordance with the Company's 2006 Employee Equity Compensation Restricted Stock Plan and the restrictions shall lapse ratably over a three-year period.

37

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### (10) Commitments and Contingencies (Continued)

##### Operating Lease

The Company leases its 50,000 square foot executive offices and warehouse facility under a non-cancelable operating lease, through May 31, 2009. The Company is responsible for certain maintenance costs, taxes and insurance under this lease. The future minimum annual lease payments are as follows:

Years Ending March 31,	
2008	\$ 500,000
2009	520,000
2010	87,000
	-----
Total lease payments	\$ 1,107,000
	=====

Rent expense was \$481,000, \$435,000 and \$383,000 for the years ended March 31, 2007, 2006 and 2005, respectively.

#### (11) Sales by Category

The following table provides a breakdown of the

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percentage of our total sales by each category during the indicated periods:

	Year Ended March 31,		
	2007	2006	2005
	-----	-----	-----
Non-prescription medications	70%	70%	69%
Prescription medications	29%	29%	30%
Shipping and handling charges and other	1%	1%	1%
	-----	-----	-----
Total	100%	100%	100%
	=====	=====	=====

### (12) Quarterly Financial Data (Unaudited)

Summarized unaudited quarterly financial data for fiscal 2007 and 2006 is as follows:

Quarter Ended:	June 30, 2006	September 30, 2006	December 31, 2006	March 31, 2007
	-----	-----	-----	-----
Sales	\$ 50,673,353	\$ 43,812,754	\$ 31,352,277	\$ 36,400,000
Gross Profit	\$ 20,124,325	\$ 16,922,641	\$ 12,788,877	\$ 14,700,000
Income from operations	\$ 7,211,684	\$ 4,800,446	\$ 3,865,329	\$ 5,600,000
Net income	\$ 4,750,258	\$ 3,314,971	\$ 2,754,234	\$ 3,600,000
Diluted net income per common share	\$ 0.20	\$ 0.14	\$ 0.11	\$ 0.15

Quarter Ended:	June 30, 2005	September 30, 2005	December 31, 2005	March 31, 2006
	-----	-----	-----	-----
Sales	\$ 43,631,758	\$ 38,652,674	\$ 25,890,095	\$ 29,400,000
Gross Profit	\$ 16,858,586	\$ 14,850,852	\$ 10,276,380	\$ 12,300,000
Income from operations	\$ 5,273,844	\$ 3,987,598	\$ 3,891,063	\$ 4,900,000
Net income	\$ 3,541,586	\$ 2,710,826	\$ 2,672,092	\$ 3,100,000
Diluted net income per common share	\$ 0.15	\$ 0.11	\$ 0.11	\$ 0.15

38

### REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of the Company is responsible for the preparation and integrity of the Consolidated Financial Statements appearing in our Annual Report on Form 10-K. The financial statements were prepared in conformity with generally accepted accounting principles appropriate in the circumstances and, accordingly, include certain amounts based on our best judgments and estimates. Financial information in the Annual Report on Form 10-K is consistent with that in the financial statements.

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) under

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the Securities Exchange Act of 1934 ("Exchange Act"). The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Consolidated Financial Statements. Our internal control over financial reporting is supported by a team of consultants and appropriate reviews by management, written policies and guidelines, careful selection and training of qualified personnel, and a written Corporate Code of Business Conduct and Ethics adopted by our Company's Board of Directors, applicable to all Company Directors and all officers and employees of our Company and subsidiaries.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements and even when determined to be effective, can only provide reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Audit Committee ("Committee") of our Company's Board of Directors, comprised solely of Directors who are independent in accordance with the requirements of The NASDAQ Stock Market LLC listing standards, the Exchange Act and the Company's Corporate Governance Guidelines, meets with the independent auditors and management periodically to discuss internal control over financial reporting, and auditing and financial reporting matters. The Committee reviews with the independent auditors the scope and results of the audit effort. The Committee also meets periodically with the independent auditors without management present to ensure that the independent auditors have free access to the Committee. Our Audit Committee's Report can be found in the Company's 2007 Proxy Statement.

Management assessed the effectiveness of the Company's internal control over financial reporting as of March 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. Based on our assessment, management believes that the Company maintained effective internal control over financial reporting as of March 31, 2007.

The Company's independent auditors, Goldstein Golub Kessler LLP, a registered public accounting firm, are appointed by the Audit Committee of the Company's Board of Directors, subject to ratification by our Company's shareholders. Goldstein Golub Kessler LLP have audited and reported on the Consolidated Financial Statements of PetMed Express, Inc. and subsidiaries, management's assessment of the effectiveness of the Company's internal control over financial reporting, and the effectiveness of the Company's management's assessment of the effectiveness of our internal control over financial reporting. The reports of the independent auditors are contained in our Annual Report on Form 10-K.

/s/ Menderes Akdag  
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Menderes Akdag  
Chief Executive Officer, President, Director

May 31, 2007

/s/ Bruce S. Rosenbloom  
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Bruce S. Rosenbloom  
Chief Financial Officer

May 31, 2007

39

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Stockholders  
PetMed Express, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that PetMed Express, Inc. maintained effective internal control over financial reporting as of March 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). PetMed Express, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's

internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that PetMed Express, Inc. maintained effective internal control over financial reporting as of March 31, 2007 is fairly stated, in all material respects, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, PetMed Express, Inc. maintained, in all material respects, effective internal control over financial reporting as of March 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the March 31, 2007 consolidated financial statements of PetMed Express, Inc. and our report dated May 31, 2007 expressed an unqualified opinion on those financial statements.

/s/ Goldstein Golub Kessler LLP

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Goldstein Golub Kessler LLP

New York, New York  
May 31, 2007

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### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

### ITEM 9A. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

The Company's management, including our Chief Executive Officer and Chief Financial Officer, has conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-14(c) promulgated under the Securities Exchange Act of 1934, as amended) as of the year ended March 31, 2007, the end of the period covered by this report (the "Evaluation Date"). 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.

#### Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control - Integrated Framework, our management concluded that the Company maintained effective internal control over financial reporting as of March 31, 2007. Our management's assessment of the effectiveness of our internal control over financial reporting as of March 31, 2007 has been audited by Goldstein Golub Kessler LLP, an independent registered public accounting firm, as stated in their report which is included herein.

#### Changes in Internal Controls over Financial Reporting

There have been no significant changes made in our internal controls over financial reporting or in other factors that could significantly affect our internal controls over financial reporting during our last fiscal quarter identified in connection with the evaluation referred to above.

### ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information required by this item will be set forth in our Proxy Statement relating to our 2007 Annual Meeting of Stockholders to be held on August 3, 2007, and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item will be set forth in our Proxy Statement relating to our 2007 Annual Meeting of Stockholders to be held on August 3, 2007, and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item (other than information required by Item 201(d) of Regulation S-K with respect to equity compensation plans, which is set forth under Item 5. in this Annual Report on Form 10-K) will be set forth in our Proxy Statement relating to our 2007 Annual Meeting of Stockholders to be held on August 3, 2007, and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item will be set forth in our Proxy Statement relating to our 2007 Annual Meeting of Stockholders to be held on August 3, 2007, and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item will be set forth in our Proxy Statement relating to our 2007 Annual Meeting of Stockholders to be held on August 3, 2007, and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

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(a) The following documents are filed as part of this report on Form 10-K.

(1) Consolidated Financial Statements

The following exhibits are filed as part of this report on Form 10-K.

(3) Articles of Incorporation and By-Laws

3.1 Amended and Restated Articles of Incorporation (1)

3.2 By-Laws of the Corporation (1)

(4) Instruments Defining the Rights of Security Holders

4.1 Form of Warrant issued to Noble International Investments, Inc. (1)

4.2 Specimen common stock certificate (1)

(10) Material Contracts

10.1 1998 Stock Option Plan (1)

10.2 Employment Agreement with Menderes Akdag (incorporated by reference to Exhibit 10 of the Registrant's Form 8-K on March 16, 2001, Commission File No. 000-28827).

10.3 Agreement for the Sale and Leaseback of the Land and Building (incorporated by reference to Exhibit 99.1 of the Registrant's Form 8-K on June 14, 2001, Commission File No. 000-28827).

10.4 Amendment Number 1 to Executive Employment Agreement with Menderes Akdag (incorporated by reference to Exhibit 99.1 of the Registrant's Form 8-K on March 16, 2004, Commission File No. 000-28827).

10.5 Termination of Marc Puleo's Executive Employment Agreement (incorporated by reference to Exhibit 10.13 of the Registrant's Form 8-K on August 1, 2005, Commission File No. 000-28827).

10.6 Amendment Number 2 to Executive Employment Agreement with Menderes Akdag (incorporated by reference to Exhibit 99.1 of the Registrant's Form 8-K on March 16, 2007, Commission File No. 000-28827).

10.7 2006 Employee Equity Compensation Restricted Stock Plan (incorporated by reference in our definitive Proxy Statement for our 2006 Annual Meeting of Stockholders held on July 28, 2006).

10.8 2006 Outside Director Equity Compensation Restricted Stock Plan (incorporated by reference in our definitive Proxy Statement for our 2006 Annual Meeting of Stockholders held on July 28, 2006).

(14) Corporate Code of Ethics

14.1 Corporate Code of Ethics (incorporated by reference in our definitive Proxy Statement for our 2004 Annual Meeting of Stockholders held on August 6, 2004).

(21) Subsidiaries of Registrant

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21.1 Subsidiaries of Registrant (filed herewith).

43

(31) Certifications

- 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, promulgated under the Securities Exchange Act of 1934, as amended (filed herewith to Exhibit 31.1 of the Registrant's Report on Form 10-K for the year ended March 31, 2007, Commission File No. 000-28827).
- 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, promulgated under the Securities Exchange Act of 1934, as amended (filed herewith to Exhibit 31.2 of the Registrant's Report on Form 10-K for the year ended March 31, 2007, Commission File No. 000-28827).

(32) Certifications

- 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith to Exhibit 32.1 of the Registrant's Report on Form 10-K for the year ended March 31, 2007, Commission File No. 000-28827).
- (1) Incorporated by reference to the Registration Statement on Form 10-SB, File No. 000-28827, as amended, as filed with the Securities and Exchange Commission.

44

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: June 1, 2007

PETMED EXPRESS, INC.

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(the "Registrant")

By: /s/ Menderes Akdag

-----  
Menderes Akdag  
Chief Executive Officer and President  
(principal executive officer)

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on June 1, 2007.

SIGNATURE	TITLE
/s/ Menderes Akdag ----- Menderes Akdag	Chief Executive Officer and President (principal executive officer) Officer and Director
/s/ Robert C. Schweitzer ----- Robert C. Schweitzer	Chairman of the Board  Director
/s/ Bruce S. Rosenbloom ----- Bruce S. Rosenbloom	Chief Financial Officer and Treasurer (principal financial and accounting officer) Officer
/s/ Ronald J. Korn ----- Ronald J. Korn	Director
/s/ Gian M. Fulgoni ----- Gian M. Fulgoni	Director
/s/ Frank J. Formica ----- Frank J. Formica	Director