PETMED EXPRESS INC
Form 10-Q
November 10, 2004

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2004

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.

(Exact name of registrant as specified in its charter)

FLORIDA	65-0680967
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

(Address of principal executive offices)

(954) 979-5995

(Issuer's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 23,418,723 Common Shares, $.001 par value per share at November 5, 2004.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

PETMED EXPRESS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2004 (UNAUDITED)	March 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,789,914	$ 3,278,926
Accounts receivable, less allowance for doubtful accounts of $15,439 and $22,987, respectively	761,861	1,133,301
Inventories - finished goods	9,412,843	11,179,858
Prepaid expenses and other current assets	330,892	232,218
Total current assets	21,295,510	15,824,303
Property and equipment, net	1,484,557	1,688,327
Deferred income taxes	581,356	581,356
Intangible asset	365,000	365,000
Other assets	14,167	21,822
Total assets	$ 23,740,590	$ 18,480,808
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,298,472	$ 3,273,062
Income taxes payable	584,835	422,445
Accrued expenses and other current liabilities	448,634	722,350
Loan obligation	0	68,442
Total liabilities	4,331,941	4,486,299
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	8,898
Common stock, $.001 par value, 40,000,000 shares authorized; 23,018,723 and 21,860,057 shares issued and outstanding, respectively	23,019	21,860
Additional paid-in capital	11,647,213	9,864,025
Retained earnings	7,729,519	4,099,726
Total shareholders' equity	19,408,649	13,994,509
Total liabilities and shareholders' equity	$ 23,740,590	$ 18,480,808

See accompanying notes to condensed consolidated financial statements

1

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Sales	$ 28,754,697	$ 24,969,228	$ 64,043,225	$ 55,356,79
Cost of sales	17,141,556	14,745,824	38,568,275	33,328,50
Gross profit	11,613,141	10,223,404	25,474,950	22,028,28
Operating expenses:				
General and administrative	2,971,268	2,718,371	6,193,173	5,739,62
Advertising	5,629,991	4,443,980	13,384,820	10,952,97
Depreciation and amortization	155,294	132,049	314,353	259,40
Total operating expenses	8,756,553	7,294,400	19,892,346	16,951,99
Income from operations	2,856,588	2,929,004	5,582,604	5,076,29
Other income (expense):				
Interest expense	(138)	(1,526)	(880)	(4,20
Interest income	17,372	4,705	22,005	6,85
Other, net	1,821	378	1,411	98
Total other income (expense)	19,055	3,557	22,536	3,63
Income before provision for income taxes	2,875,643	2,932,561	5,605,140	5,079,92
Provision for income taxes	1,063,988	1,114,373	1,975,347	1,829,15
Net income	$ 1,811,655	$ 1,818,188	$ 3,629,793	$ 3,250,77
Net income per common share:				
Basic	$ 0.08	$ 0.09	$ 0.16	$ 0.1
Diluted	$ 0.08	$ 0.08	$ 0.15	$ 0.1
Weighted average number of common shares outstanding:				
Basic	22,719,266	19,372,365	22,370,162	19,192,39
Diluted	23,860,513	23,425,269	23,463,939	23,103,91

See accompanying notes to condensed consolidated financial statements

2

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

	Six Months Ended September 30, 2004	2003
Cash flows from operating activities:		
Net income	$ 3,629,793	$ 3,250,772
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	314,353	259,400
Tax benefit related to stock options exercised	690,512	486,151
Bad debt expense	5,852	(672)
(Increase) decrease in operating assets and liabilities:		
Accounts receivable	365,588	(116,753)
Inventories- finished goods	1,767,015	(2,708,838)
Prepaid expenses and other current assets	(98,674)	52,097
Other assets	7,655	178,333
Accounts payable	25,410	498,049
Income taxes payable	162,390	760,194
Accrued expenses and other current liabilities	(273,716)	131,697
Net cash provided by operating activities	6,596,178	2,790,430
Cash flows from investing activities:		
Purchases of property and equipment	(110,583)	(231,665)
Net cash used in investing activities	(110,583)	(231,665)
Cash flows from financing activities:		
Proceeds from the exercise of stock options and warrants and other transactions	1,093,835	1,185,134
Payments on loan obligation	(68,442)	(34,222)
Net cash provided by financing activities	1,025,393	1,150,912
Net increase in cash and cash equivalents	7,510,988	3,709,677
Cash and cash equivalents, at beginning of period	3,278,926	984,169
Cash and cash equivalents, at end of period	$ 10,789,914	$ 4,693,846
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 802	$ 3,984

Cash paid for income taxes	$ 1,122,445	$ 536,667

See accompanying notes to condensed consolidated financial statements

3

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

Note 1: Summary of Significant Accounting Policies

Organization

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

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

The Company's fiscal year end is March 31, and references herein to fiscal 2005 or 2004 refer to the Company's fiscal years ending March 31, 2005 and 2004, respectively.

Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position of the Company, after elimination of intercompany accounts and transactions, at September 30, 2004 and the statements of income for the three and six months ended September 30, 2004 and 2003 and cash flows for the six months ended September 30, 2004 and 2003. The results of operations for the three and six months ended September 30, 2004 and 2003 are not necessarily indicative of the operating results expected for the fiscal year ending March 31, 2005. These financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's annual report on Form 10-K for the fiscal year ended March 31, 2004. The condensed consolidated financial statements include the accounts of PetMed Express, Inc. and its wholly owned subsidiaries. All significant intercompany transactions have been eliminated upon consolidation.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with generally accepted accounting principles in the United

States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 2: 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 share includes the dilutive effect of potential stock options and warrants exercised and the effects of the potential conversion of preferred shares, calculated using the treasury stock method. Outstanding stock options, warrants, 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:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Net income (numerator):				
Net income	$ 1,811,655	$ 1,818,188	$ 3,629,793	$ 3,250,77
Shares (denominator):				
Weighted average number of common shares outstanding used in basic computation	22,719,266	19,372,365	22,370,162	19,192,39
Common shares issuable upon exercise of stock options and warrants	1,131,122	4,042,779	1,083,652	3,901,40
Common shares issuable upon conversion of preferred shares 10,125	10,125	10,125	10,125	
Shares used in diluted computation	23,860,513	23,425,269	23,463,939	23,103,91
Net income per common share:				
Basic	$ 0.08	$ 0.09	$ 0.16	$ 0.1
Diluted	$ 0.08	$ 0.08	$ 0.15	$ 0.1

For the three and six months ended September 30, 2004 and 2003, 485,500 and 55,000 shares of common stock options, with a weighted average exercise price of $9.69 and $7.95, respectively, 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.

Note 3: Accounting for Stock-Based Compensation

The Company accounts for employee stock options using the intrinsic value method as prescribed by Accounting Principles Board Opinion ("APB") No. 25, Accounting for Stock Issued to Employees. The Company follows the disclosure provisions of SFAS No. 123, Accounting for Stock-Based Compensation, for employee stock options. Had the Company determined employee compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123, the Company's net income would have been decreased to the pro forma amounts indicated below:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Reported net income:	$ 1,811,655	$ 1,818,188	$ 3,629,793	$ 3,250,77
Deduct: total stock-based employee compensation expense determined under fair-value based method for all awards, net of related tax effects	73,948	77,070	233,354	$ 121,92
Pro forma net income:	$ 1,737,707	$ 1,741,118	$ 3,396,439	$ 3,128,84
Reported basic net income per share:	$ 0.08	$ 0.09	$ 0.16	$ 0.1
Pro forma basic net income per share:	$ 0.08	$ 0.09	$ 0.15	$ 0.1
Reported diluted net income per share:	$ 0.08	$ 0.08	$ 0.15	$ 0.1
Pro forma diluted net income per share:	$ 0.07	$ 0.08	$ 0.14	$ 0.1

5

Note 4: Line of Credit

The Company's $5,000,000 line of credit with SouthTrust Bank, N.A. expired on August 28, 2004. On November 2, 2004 the Company signed a new $6,000,000 line of credit agreement with RBC Centura Bank. The $6,000,000 line of credit, which upon 30 days notice has a provision to increase the line to $7,500,000, is effective through November 2, 2005, and the interest rate is at the published thirty day London Interbank Offered Rates ("LIBOR") plus 1.50% (3.34% at September 30, 2004), and contains various financial and operating covenants. At September 30, 2004 and 2003, there was no outstanding balance under the line of credit agreement.

Note 5: Commitments and Contingencies

The Company is a defendant in a lawsuit, filed in August 2002, in Texas state district court seeking injunctive and monetary relief styled Texas

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

From August 17, 2004 until October 12, 2004 six shareholder class action lawsuits were filed in the United States District Court for the Southern District of Florida against PetMed Express, Inc. and certain of the Company's officers and directors for alleged violations of the federal securities laws. Five of the class action shareholder complaints contain substantive allegations identical to the complaint filed on August 17, 2004. These complaints allege violations of the anti-fraud provision contained in Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, thereunder and assert violations of Section 20(a) of that act against the individual defendants as controlling persons. The actions purport to be brought on behalf of purchasers of the Company's common stock between June 18, 2003 and July 26, 2004, and the complaints generally allege that the defendants made false or misleading statements concerning the Company's business, prospects, and operations and failed to disclose, among other things, (1) that the Company's business allegedly depends on veterinarians, who are the Company's competitors, to authorize prescriptions, (2) that the Company's business model, which, in part, requires veterinarians to authorize prescriptions, caused veterinarians to incur certain costs and burdens, which were supposedly shifted from the Company to the veterinarians, (3) the existence of a supposed increase in veterinarian refusals to comply with Company requests for prescription authorization, (4) the Company's alleged inability to guarantee the quality of, and maintain control over, pet medications and the negative impact this was having on veterinarian willingness to authorize prescriptions, and (5) that the foregoing allegations were adversely impacting the Company. The complaints also allege that the individual defendants were motivated to engage in the alleged violations so that they could affect sales of their shares of the Company's common stock at artificially inflated prices. The plaintiffs seek unspecified monetary damages. The Company is reviewing and evaluating the allegations, but at this juncture intends to defend vigorously against the allegations of wrongdoing. At this stage of the litigation it is difficult to assess any possible outcome or estimate any potential loss in the event of an adverse outcome.

The sixth class action shareholder complaint also alleges violations of the anti-fraud provision contained in Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and asserts violations of Section 20(a) of that act against the Company and the individual defendants as controlling persons. The action has purportedly been brought on behalf of purchasers of the Company's common stock between June 16, 2003 and July 26, 2004 and generally alleges that the defendants made false or misleading statements concerning the Company's business, prospects and operations and failed to disclose, among other things, (1) that the Company supposedly diverted costs to veterinarians which would ultimately cost the Company decreased sales in future periods, and (2) that the defendants allegedly risked the quality, safety, or efficacy of the Company's drugs, resulting in veterinarians declining to refill prescriptions through the Company, which would ultimately cost the Company decreased revenue. The complaint also alleges that the individual defendants were motivated to engage in the alleged violations to obtain financing for the Company and so that they could effect sales of their shares of the Company's common stock at artificially inflated prices. The plaintiff seeks unspecified monetary damages. The Company is reviewing and evaluating the allegations, but at this juncture intends to defend vigorously against the allegations of wrongdoing. At this stage of the litigation it is difficult to assess any possible outcome or estimate any

potential loss in the event of an adverse outcome.

Routine Proceedings

The Company is a party to routine litigation 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 are 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.

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

Executive Summary

PetMed Express was incorporated in the state of Florida in January 1996. The Company's common stock is traded on the Nasdaq National Market ("NASDAQ") under the symbol "PETS." Prior to the move to the NASDAQ, the Company`s shares had been traded on the over-the-counter-bulletin board. 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 health and nutritional supplements for dogs and cats. The Company markets its products through national television, on-line, and direct mail advertising campaigns which direct the consumers to order by phone or on the Internet, and aim to increase the recognition of the "1-800-PetMeds" brand name. We currently generate approximately 52% of all sales via the Internet.

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 one to three banking days for sales paid by credit cards, which minimizes the accounts receivable balances relative to the Company's sales. Certain wholesale customers are extended credit terms, which usually require payment within 30 days of delivery. The Company's sales returns average was approximately 1.6% and 1.5% of sales for the quarters ended on September 30, 2004 and 2003, respectively. The twelve month average purchase was approximately $75 and $72 per order, and the three month average purchase was approximately $74 and $71 per order for the quarters ended September 30, 2004 and 2003, respectively.

Critical Accounting Policies

Our discussion and analysis of our financial condition and the results of our operations are based upon our condensed consolidated financial statements and the data used to prepare them. The Company's condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. On an ongoing basis we re-evaluate our 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 consumer.

Outbound shipping and handling fees are included in sales and are billed upon shipment. Shipping and handling expenses are included in cost of sales.

The majority of the Company's sales are paid by credit cards and the Company usually receives the cash settlement in one 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 September 30, 2004 and 2003 the allowance for doubtful accounts was approximately $15,000 and $16,000, respectively.

Valuation of inventory

Inventories consist of prescription and non-prescription pet medications that are available for sale and are priced at the lower of cost or market value using a weighted average cost method. The Company writes down its inventory for estimated obsolescence. At September 30, 2004 and 2003 the inventory reserve was approximately $192,000 and $142,000, 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 ten years. Leasehold improvements and assets under capital lease agreements are amortized over the shorter of the underlying lease agreement or the useful life of the asset.

Long-lived assets

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

Advertising

The Company's advertising expense consists primarily of television advertising, internet marketing, and direct mail advertising. Television costs are expensed as the advertisements are televised and direct mail costs are expensed when the related print materials are produced, distributed or superseded.

Accounting for income taxes

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

Results of Operations

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2004	2003	2004	2003
Sales	100.0 %	100.0 %	100.0 %	100.
Cost of sales	59.6	59.1	60.2	60.
Gross profit	40.4	40.9	39.8	39.
Operating expenses:				
General and administrative	10.3	10.9	9.7	10.
Advertising	19.6	17.8	20.9	19.
Depreciation and amortization	0.5	0.5	0.5	0.
Total operating expenses	30.4	29.2	31.1	30.
Income from operations	10.0	11.7	8.7	9.
Provision for income taxes	3.7	4.4	3.0	3.
Net income	6.3	7.3	5.7	5.

9

Three Months Ended September 30, 2004 Compared With Three Months Ended September 30, 2003, and Six Months Ended September 30, 2004 Compared With Six Months Ended September 30, 2003

Sales

Sales increased by approximately $3,786,000, or 15.2%, to approximately $28,755,000 for the quarter ended September 30, 2004, from approximately $24,969,000 for the quarter ended September 30, 2003. For the six months ended September 30, 2004, sales increased by approximately $8,686,000, or 15.7%, to approximately $64,043,000 compared to sales of approximately $55,357,000 for the six months ended September 30, 2003. The increase in sales for the three and six months ended September 30, 2004 can be primarily attributed to increased retail reorders sales, offset by decreased new order sales.

The Company has committed certain amounts specifically designated towards television, direct mail/print and on-line advertising to stimulate sales, create brand awareness, and acquire new customers. Retail reorder sales have increased by approximately $4,333,000, or 33.6%, to approximately $17,239,000 for the three months ended September 30, 2004, from

approximately $12,906,000 for the three months ended September 30, 2003. Retail reorder sales have increased by approximately $11,773,000, or 46.3%, to approximately $37,184,000 for the six months ended September 30, 2004, from approximately $25,411,000 for the six months ended September 30, 2003. Retail new order sales have decreased by approximately $1,065,000, or 8.9%, to approximately $10,879,000 for the three months ended September 30, 2004, from approximately $11,944,000 for the three months ended September 30, 2003. Retail new order sales have decreased by approximately $3,904,000, or 13.1%, to approximately $25,808,000 for the six months ended September 30, 2004, from approximately $29,712,000 for the six months ended September 30, 2003. Wholesale sales have increased by approximately $518,000, or 435.0%, to approximately $637,000 for the three months ended September 30, 2004, from approximately $119,000 for the three months ended September 30, 2003. Wholesale sales have increased by approximately $817,000, or 349.4%, to approximately $1,051,000 for the six months ended September 30, 2004, from approximately $234,000 for the six months ended September 30, 2003. The Company acquired approximately 154,000 new customers for the quarter ended September 30, 2004, compared to approximately 166,000 new customers for the same period prior year. For the six months ended September 30, 2004 the Company acquired approximately 345,000 new customers, compared to approximately 400,000 new customers for the same period prior year.

We believe that the slowdown in sales growth for the three and six months ended September 30, 2004, compared to the sales growth for the same period in the prior year may be attributable to the change in advertising media mix and increased competition from both veterinarians and traditional and on-line retailers. During the six months ended September 30, 2004 television advertising accounted for 46% of our overall advertising expenditures, with 40% spent on direct mail/print advertising and the remainder spent on on-line advertising. In contrast during the six months ended September 30, 2003 television advertising accounted for 64% of our overall advertising expenditures, with 25% spent on direct mail/print advertising and the remainder spent on on-line advertising. Management attributes this change in the advertising media mix to a shortage of television advertising due to a strengthening economy and a surge in political advertising associated with the presidential elections. The Company anticipates this trend in advertising, which has an effect on sales, to continue into our fiscal third quarter, until the presidential elections are over.

The majority of our product sales are affected by the seasons, due to the seasonality of mainly heartworm and flea and tick medications. Industry seasonality trends, according to Fountain Agricounsel LLC, Management Consultants to Agribusiness, are divided into percentage of industry sales by quarter. For the quarters ended June 30, September 30, December 31, and March 31 industry sales are approximately 37%, 28%, 16%, and 19%, respectively. For the quarters ended June 30, September 30, December 31, and March 31 of fiscal 2004, the Company's sales were approximately 32%, 27%, 18%, and 23%, respectively.

Cost of sales

Cost of sales increased by approximately $2,396,000, or 16.3%, to approximately $17,142,000 for the quarter ended September 30, 2004, from approximately $14,746,000 for the quarter ended September 30, 2003. For the six months ended September 30, 2004, cost of sales increased by approximately $5,239,000, or 15.7%, to approximately $38,568,000 compared to cost of sales of approximately $33,329,000 for the six months ended September 30, 2003. The increase in cost of sales for the three and six months ended September 30, 2004 is directly related to the increase in retail sales. As a percent of sales, the cost of sales was 59.6% and 59.1% for the three months ended September 30, 2004 and 2003, respectively. The percentage increase can be attributed to increases in our product pricing, offset by greater increases to our product cost.

Gross profit

Gross profit increased by approximately $1,390,000, or 13.6%, to approximately $11,613,000 for the quarter ended September 30, 2004, from approximately $10,223,000 for the quarter ended September 30, 2003. For the six months ended September 30, 2004, gross profit increased by approximately $3,447,000, or 15.7%, to approximately $25,475,000 compared to gross profit of approximately $22,028,000 for the six months ended September 30, 2003. Gross profit as a percentage of sales was 40.4% and 40.9% for the three months ended September 30, 2004 and 2003, respectively. The percentage decrease can be attributed to increases in our product pricing, offset by greater increases to our product cost.

General and administrative expenses

General and administrative expenses increased by approximately $253,000, or 9.3%, to approximately $2,971,000 for the quarter ended September 30, 2004, from approximately $2,718,000 for the quarter ended September 30, 2003. For the six months ended September 30, 2004, general and administrative expenses increased by approximately $453,000, or 7.9%, to approximately $6,193,000 compared to general and administrative expenses of approximately $5,740,000 for the six months ended September 30, 2003. The increase in general and administrative expenses for the three months ended September 30, 2004 was primarily due to the following: a $124,000 increase to payroll expenses which can be attributed to the addition of new employees in the customer service and pharmacy departments enabling the company to sustain its growth; a $76,000 increase to insurance expense, relating to increases to insurance policy limits; a $75,000 increase to bank service and credit card fees, which can be directly attributed to increased sales; a $41,000 increase to property expenses, relating to additional rent due to our warehouse expansion; and a $7,000 increase to other expenses. Offsetting the increase were a $35,000 reduction to professional fees, primarily relating to a reduction in legal fees; and a $35,000 reduction to telephone expenses.

The increase in general and administrative expenses for the six months ended September 30, 2004 was primarily due to the following: a $361,000 increase to payroll expenses which can be attributed to the addition of new employees in the customer service and pharmacy departments enabling the company to sustain its growth; a $168,000 increase to bank service and credit card fees, which can be directly attributed to increased sales; a $79,000 increase to property expenses, relating to additional rent due to our warehouse expansion; a $72,000 increase to insurance expense, relating to increases to insurance policy limits; and a $32,000 increase to other expenses. Offsetting the increase were a $154,000 reduction to professional fees, primarily relating to a reduction in legal fees; and a $105,000 reduction to telephone expenses.

Advertising expenses

Advertising expenses increased by approximately $1,186,000, or 26.7%, to approximately $5,630,000 for the quarter ended September 30, 2004, from approximately $4,444,000 for the quarter ended September 30, 2003. For the six months ended September 30, 2004, advertising expenses increased by approximately $2,432,000, or 22.2%, to approximately $13,385,000 compared to advertising expenses of approximately $10,953,000 for the six months ended September 30, 2003. The increase in advertising expenses for the three and six months ended September 30, 2004 was due to the Company's plan to commit certain amounts specifically designated towards television,

direct mail/print and on-line advertising to stimulate sales, create brand awareness, and acquire new customers. The advertising costs of acquiring a new customer for the quarter ended September 30, 2004 was $37, compared to $27 for the same quarter the prior year and for the six months ended September 30, 2004, the advertising cost of acquiring a new customer was $39, compared to $27 for the same period prior year. We attribute this decrease in advertising efficiency to the change in the advertising media mix caused by a shortage of television advertising due to the strengthening economy and the presidential elections. The decrease in advertising efficiency may also be attributable to increased competition from both veterinarians and traditional and on-line retailers. As a percentage of sales, advertising expense was 19.6% and 17.8% for the three months ended September 30, 2004 and 2003 and 20.9% and 19.8% for the six months ended September 30, 2004 and 2003, respectively. The Company expects advertising as a percentage of sales to range from approximately 18.0% to 22.0% in fiscal 2005. However, that advertising percentage will fluctuate quarter to quarter due to seasonality and advertising availability.

Depreciation and amortization expenses

Depreciation and amortization expenses increased by approximately $23,000, or 17.6%, to approximately $155,000 for the quarter ended September 30, 2004, from approximately $132,000 for the quarter ended September 30, 2003. For the six months ended September 30, 2004, depreciation and amortization expenses increased by approximately $55,000, or 21.2%, to approximately $314,000 compared to depreciation and amortization expenses of approximately $259,000 for the six months ended September 30, 2003. This increase to depreciation and amortization expense for three and six months ended September 30, 2004 can be attributed to increased property and equipment additions.

Interest income

Interest income increased by approximately $12,000, or 269.2%, to approximately $17,000 for the quarter ended September 30, 2004, from approximately $5,000 for the quarter ended September 30, 2003. For the six months ended September 30, 2004, interest income increased by approximately $15,000, or 221.1%, to approximately $22,000 compared to interest income of approximately $7,000 for the six months ended September 30, 2003. Interest income may decrease in future quarters as the Company utilizes its cash balances to increase inventory levels.

Provision for income taxes

The Company had incurred significant net losses since its inception in 1996, through the quarter ended September 30, 2001. These losses have resulted in net operating loss carryforwards, which have been used by the Company to offset its tax liabilities. For the fiscal year ended March 31, 2002, the Company recorded a full valuation allowance against the deferred income tax assets, created by net operating losses, since future utilization of these assets was subject to the Company's ability to generate taxable income. For the fiscal year ended March 31, 2003, the Company recognized a deferred income tax asset of approximately $581,000, due to the fact that the Company had demonstrated the ability to generate taxable income. There are no guarantees that the Company will be able to utilize all future net operating loss carryforwards unless the Company generates taxable income. For the quarters ended September 30, 2004 and 2003, the Company recorded an income tax provision for approximately

$1,064,000 and $1,114,000, respectively, to provide for taxable income as the utilization of net operating loss carryforwards is limited.

Liquidity and Capital Resources

The Company's working capital at September 30, 2004 and March 31, 2004 was $16,964,000 and $11,338,000, respectively. The $5,626,000 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 $6,596,000 and $2,790,000 for the six months ended September 30, 2004 and 2003, respectively. Net cash used in investing activities was $111,000 and $232,000 for the six months ended September 30, 2004 and 2003, respectively. Net cash provided by financing was $1,025,000 and $1,151,000 for the six months ended September 30, 2004 and 2003, respectively.

The Company maintains a $6,000,000 line of credit, which upon 30 days notice has a provision to increase the line to $7,500,000, effective through November 2, 2005. The interest rate is at the published thirty day London Interbank Offered Rates ("LIBOR") plus 1.50% (3.34% at September 30, 2004), and contains various financial and operating covenants. At September 30, 2004 and 2003, there was no outstanding balance under the line of credit agreement.

On July 25, 2003 the Company signed an amendment to its current lease agreement to obtain an additional 8,000 square feet, with an option to add another 3,600 square feet, to its current 32,000 square foot facility, which became available on October 1, 2003. This addition to the warehouse was necessary to increase the Company's capacity to store additional inventory during our peak season. As of September 30, 2004 the Company had no other outstanding lease commitments. The Company's sources of working capital include the line of credit, cash from operations, and the exercise of stock options and warrants. For the remainder of fiscal 2005, the Company has approximately $170,000 planned for capital expenditure to maintain existing capital assets and to add additional computer equipment to further the Company's growth. These capital expenditures will be funded through cash from operations.

The Company presently has no need for other alternative sources of working capital. The Company may seek 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. At this time, the Company has no commitments or plans to obtain additional capital. Further, there can be no assurances that even if such additional capital is obtained that the Company will sustain profitability or positive cash flow.

Cautionary Statement Regarding Forward-Looking Information

Certain information in this Quarterly Report on Form 10-Q 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 currently available to us. Because these statements reflect our current views concerning future events, these statements involve risks, uncertainties and assumptions. Actual future results may differ significantly from the results discussed in the forward-looking

statements. A reader, whether investing in our common stock or not, should not place undue reliance on these forward-looking statements, which apply only as of the date of this quarterly report.

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

Item 3. 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, accounts receivable, accounts payable, line of credit, and debt obligations. The book values of cash equivalents, accounts receivable, and accounts payable are considered to be representative of fair value because of the short maturity of these instruments. As of September 30, 2004 the Company had no outstanding 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. Our exposure to market risk for changes in interest rates relates primarily to our obligations under our line of credit. As of November 5, 2004, there was no outstanding balance under the line of credit agreement. A ten percent increase in short-term interest rates on the variable rate debts outstanding as of November 5, 2004 would not have a material impact on our quarterly interest expense, assuming the amount of debt outstanding remains constant.

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 4. Controls and Procedures.

The Company's management, including our Chief Executive Officer and Chief Financial Officer, have 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 quarter ended September 30, 2004, 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. There have been no significant changes made in our internal controls or in other factors that could significantly affect our internal controls over financial reporting during the period covered by this report.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

None

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities

None

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

We held our annual stockholders' meeting in Pompano Beach, Florida on August 6, 2004. Stockholders voted:

1. To elect six directors to the board of directors, to serve until the next annual meeting of stockholders or until the director is succeeded by another director who has been elected;

2. To ratify the appointment of Goldstein Golub Kessler LLP, as independent auditors.

With a majority of the outstanding shares voting either by proxy or in person, the stockholders approved the proposals, voting as follows:

Proposal 1.	For	Against
Election of directors:		
Menderes Akdag	21,092,900	21,180
Frank J. Formica	14,258,193	6,862,631
Gian Fulgoni	14,263,900	6,855,200
Ronald J. Korn	14,263,900	6,854,874
Marc Puleo, M.D.	20,294,155	946,115
Robert C. Schweitzer	14,253,900	6,865,100

Proposal 2.	For	Against	Abstain
To ratify the appointment of Goldstein, Golub Kessler LLP, as independent auditors.	21,078,319	30,229	10,340

Item 5. Other Information.

None

Item 6. Exhibits.

(a) The following exhibits are filed as part of this report.

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-Q for the quarter ended September 30, 2004, 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-Q for the quarter ended September 30, 2004, Commission File No. 000-28827).

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-Q for the quarter ended September 30, 2004, Commission File No. 000-28827).

10.12 New $6.0 million Line of Credit Agreement with RBC Centura Bank (filed herewith to Exhibit 10.12 of the Registrant's Report on Form 10-Q for the quarter ended September 30, 2004, Commission File No. 000-28827).

SIGNATURES

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

PETMED EXPRESS, INC.
(The "Registrant")

Date: November 5, 2004

By: /s/ Menderes Akdag

Menderes Akdag

Chief Executive Officer
(principal executive officer)

By: /s/ Bruce S. Rosenbloom

Bruce S. Rosenbloom

Chief Financial Officer
(principal financial and accounting officer)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

PETMED EXPRESS, INC

FORM 10-Q

FOR THE QUARTER ENDED:

SEPTEMBER 30, 2004

EXHIBITS

EXHIBIT INDEX

Exhibit Number	Description	Number of Pages in Original Document	Incorporated By Reference
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley	1	**

	Act of 2002		
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	1	**
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	1	**
10.12	New $6.0 million Line of Credit Agreement with RBC Centura Bank	29	**

** Filed herewith