PETMED EXPRESS INC
Form 10-Q
February 05, 2007

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 December 31, 2006

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, including zip code)

(954) 979-5995
(Registrant'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 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 (defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 24,219,317 Common Shares, $.001 par value per share at February 2, 2007.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

PETMED EXPRESS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2006 (UNAUDITED)	March 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 38,169,594	$ 23,216,907
Accounts receivable, less allowance for doubtful accounts of $19,000 and $23,000, respectively	921,151	1,155,781
Inventories - finished goods	10,031,304	14,997,675
Prepaid expenses and other current assets	1,979,083	583,038
Total current assets	51,101,132	39,953,401
Property and equipment, net	1,924,848	1,497,589
Deferred income taxes	1,018,739	794,002
Intangible asset	365,000	365,000
Other assets	-	14,167
Total assets	$ 54,409,719	$ 42,624,159
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,652,398	$ 3,052,953
Income taxes payable	-	958,318
Accrued expenses and other current liabilities	854,802	973,359
Total liabilities	4,507,200	4,984,630
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; 24,216,217 and 23,967,390 shares issued and outstanding, respectively	24,216	23,967
Additional paid-in capital	14,876,332	13,433,054
Retained earnings	34,993,073	24,173,610
Total shareholders' equity	49,902,519	37,639,529
Total liabilities and shareholders' equity	$ 54,409,719	$ 42,624,159

See accompanying notes to condensed consolidated financial statements

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Sales	$ 31,352,277	$ 25,890,095	$ 125,838,384	$ 108,174,527
Cost of sales	18,563,400	15,613,715	76,002,541	66,188,709
Gross profit	12,788,877	10,276,380	49,835,843	41,985,818
Operating expenses:				
General and administrative	4,022,852	3,060,580	12,792,177	10,722,151
Advertising	4,771,341	3,189,099	20,770,700	17,716,234
Depreciation and amortization	129,355	135,638	395,507	394,928
Total operating expenses	8,923,548	6,385,317	33,958,384	28,833,313
Income from operations	3,865,329	3,891,063	15,877,459	13,152,505
Other income (expense):				
Interest income	329,141	215,590	917,125	467,742
Other, net	94,964	49,147	332,129	171,255
Loss on disposal of property and equipment	-	-	(1,250)	-
Total other income (expense)	424,105	264,737	1,248,004	638,997

Income before provision for income taxes	4,289,434	4,155,800	17,125,463	13,791,502
Provision for income taxes	1,535,200	1,483,708	6,306,000	4,866,998
Net income	$ 2,754,234	$ 2,672,092	$ 10,819,463	$ 8,924,504
Net income per common share:				
Basic	$ 0.11	$ 0.11	$ 0.45	$ 0.38
Diluted	$ 0.11	$ 0.11	$ 0.44	$ 0.37
Weighted average number of common shares outstanding:				
Basic	24,213,937	23,680,221	24,132,289	23,572,211
Diluted	24,382,861	24,255,705	24,316,117	24,105,124

See accompanying notes to condensed consolidated financial statements

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

	Nine Months Ended December 31, 2006	2005
Cash flows from operating activities:		
Net income	$ 10,819,463	$ 8,924,504
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	395,507	394,928
Stock based compensation relating to stock issuances	777,426	-
Tax benefit related to stock options exercised	-	212,856
Deferred income taxes	(224,737)	(47,987)
Loss on disposal of property and equipment	1,250	-
Bad debt expense (recovery)	16,038	(16,144)
(Increase) decrease in operating assets and increase (decrease) in liabilities:		
Accounts receivable	218,592	1,154,174
Inventories - finished goods	4,966,371	(392,566)
Prepaid expenses and other current assets	(1,396,045)	(161,151)
Other assets	14,167	-
Accounts payable	599,445	(865,887)
Income taxes payable	(958,318)	3,974,996
Accrued expenses and other current liabilities	(118,557)	370,865

Net cash provided by operating activities	15,110,602	13,548,588
Cash flows from investing activities:		
Purchases of property and equipment	(824,416)	(250,302)
Net proceeds from the sale of property and equipment	400	-
Net cash used in investing activities	(824,016)	(250,302)
Cash flows from financing activities:		
Proceeds from the exercise of stock options	435,064	661,263
Tax benefit related to stock options exercised	231,037	-
Net cash provided by financing activities	666,101	661,263
Net increase in cash and cash equivalents	14,952,687	13,959,549
Cash and cash equivalents, at beginning of period	23,216,907	12,680,962
Cash and cash equivalents, at end of period	$ 38,169,594	$ 26,640,511
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$ 8,104,063	$ 727,132

See accompanying notes to condensed consolidated financial statements

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

Note 1: Summary of Significant Accounting Policies

Organization

PetMed Express, Inc. and subsidiaries, d/b/a 1-800-PetMeds (the "Company"), 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, acquire new customers, 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, and references herein to fiscal 2007 or 2006 refer to the Company's fiscal years ending March 31, 2007 and 2006, 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 December 31, 2006 and the Statements of Income for the three and nine months ended December 31, 2006 and 2005 and Statements of Cash Flows for the nine months ended December 31, 2006 and 2005. The results of operations for the three and nine months ended December 31, 2006 are not necessarily indicative of the operating results expected for the fiscal year ending March 31, 2007. 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, 2006. 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 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 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.

Recently Issued Accounting Standards

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 are effective for fiscal years beginning after December 15, 2006. We do not expect FIN 48 will have a material effect on our consolidated financial position, results of operations or cash flows.

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

Note 2: Net Income Per Share

In accordance with the provisions of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share," basic net income per common 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.

	Three Months Ended December 31, 2006	Three Months Ended December 31, 2005	Nine Months Ended December 31, 2006	Nine Months Ended December 31, 2005
Net income (numerator):				
Net income	$ 2,754,234	$ 2,672,092	$ 10,819,463	$ 8,924,504
Shares (denominator):				
Weighted average number of common shares outstanding used in basic computation	24,213,937	23,680,221	24,132,289	23,572,211
Common shares issuable upon exercise of stock options	158,799	565,359	173,703	522,788
Common shares issuable upon conversion of preferred shares	10,125	10,125	10,125	10,125
Shares used in diluted computation	24,382,861	24,255,705	24,316,117	24,105,124
Net income per common share:				
Basic	$ 0.11	$ 0.11	$ 0.45	$ 0.38
Diluted	$ 0.11	$ 0.11	$ 0.44	$ 0.37

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per common share computations for the periods presented:

For the three and nine months ended December 31, 2006, and for the three months ended December 31, 2005, 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. For the nine months ended December 31, 2005, 250,000 shares issuable upon the exercise of common stock options, with a weighted average exercise price of $10.64, were excluded from the diluted net income per common share computation as their exercise prices were greater than the average market price of the common shares for the periods, therefore the effect would have been anti-dilutive.

Note 3: Accounting for Stock-Based Compensation

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 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 three and nine months ended December 31, 2006 includes $223,000 and $669,000 of compensation expense, respectively. The compensation expense related to all of the Company's stock-based compensation arrangements is recorded as a component of general and administrative expenses.

At December 31, 2006, the Company had one stock option plan. The PetMed Express, Inc. 1998 Stock Option Plan (the "Plan"), provides for the issuance of qualified options to officers and key employees, and nonqualified options to directors, consultants and other service providers, to purchase the Company's common stock. The Company had 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 668,968 and 1,090,005 options outstanding under the Plan at December 31, 2006 and 2005, 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.

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 following weighted-average assumptions were used for option grants during the nine month period ended December 31, 2005: risk-free interest rates ranging from 4 percent, expected volatility of 66 percent, no dividend yield, and expected lives of 4 years. No assumptions were necessary for the nine months ended December 31, 2006, due to the fact that no stock options were granted during the period. The risk free interest rate for the nine months ended December 31, 2005 was 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.

A summary of the status of the Company's stock option plan as of December 31, 2006 is as follows:

	Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractural Term (years)	A I
Options outstanding at March 31, 2006	851,170	$ 7.28		
Options granted	-	-		
Options exercised	(182,202)	2.39		
Options forfeited or expired	-	-		
Options outstanding at December 31, 2006	668,968	8.62	2.99	5
Options vested and exercisable at December 31, 2006	376,467	8.94	2.10	3

A summary of the status of the Company's non-vested shares as of December 31, 2006 is presented below:

	Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractural Term (years)
Non-vested shares at March 31, 2006	460,336	$ 7.81	
Options granted	-	-	
Options vested	(167,835)	7.11	
Options forfeited or expired	-	-	
Non-vested shares at December 31, 2006	292,501	$ 8.21	3.73

As of December 31, 2006, there was $1,288,000 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 3.25 years.

For stock options granted prior to the adoption of SFAS No. 123R, 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, and related interpretations in accounting for its stock options in determining stock-based compensation for awards under the plan:

	Three Months Ended December 31, 2005	Nine Months Ended December 31, 2005
Reported net income:	$ 2,672,092	$ 8,924,504
Deduct: total stock-based employee compensation expense determined under fair-value based method for all awards, net of related tax effects	152,818	443,616
Pro forma net income:	$ 2,519,274	$ 8,480,888
Reported basic net income per share:	$ 0.11	$ 0.38
Pro forma basic net income per share:	$ 0.11	$ 0.36
Reported diluted net income per share:	$ 0.11	$ 0.37
Pro forma diluted net income per share:	$ 0.10	$ 0.35

Cash received from stock options exercised for the nine months ended December 31, 2006 and 2005 was $435,000 and $661,000, respectively. The income tax benefits from stock options exercised totaled $231,000 and $213,000 for the nine months ended December 31, 2006 and 2005, respectively.

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 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 46,625 restricted common shares issued under the Employee Plan and 20,000 restricted common shares issued under the Director Plan at December 31, 2006, the fair value of which is being amortized over the three-year period. For the three and nine months ended December 31, 2006 the Company recognized $65,000 and $108,000 of compensation expense related to the Employee and Director Plans, respectively.

Note 4: Commitments and Contingencies

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 which had originally been filed solely against Dr. Puleo in March 2003. This action is based upon allegations by the plaintiff that Dr. Puleo individually entered into a written agreement with the plaintiff (the purported "General Agreement," of which the plaintiff has not produced an original document) which in pertinent part granted plaintiff 50% of any salary, stock or stock options received by Dr. Puleo from the Company for so long as the Company remains in business. The plaintiff now alleges that the Company's past and continuing failure to disclose the purported General Agreement in filings with the SEC has caused the plaintiff to suffer damages. The plaintiff is seeking a judgment against the Company for specific performance and unspecified damages, pre- and post-judgment interest, court fees and such other relief as the court deems appropriate. The Company believes that, based on information currently available to it, the claims being asserted against it are factually and legally without merit, and the Company intends to vigorously defend against such claims.

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.

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." 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, on-line, 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. For the quarter ended December 31, 2006, approximately 63% of all sales were generated via the Internet compared to 57% for the same period 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. 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% for the quarter ended December 31, 2006, compared to 1.7% for the quarter ended on December 31, 2005. The three-month average retail purchase was approximately $75 per order for the quarter ended December 31, 2006, compared to $74 per order for the quarter ended December 31, 2005. The nine-month average retail purchase was approximately $79 per order for the nine months ended December 31, 2006, compared to $76 per order for the nine months ended December 31, 2005.

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 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 December 31, 2006 and 2005 the allowance for doubtful accounts was approximately $19,000 and $13,000, 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. At December 31, 2006 and 2005, the inventory reserve was approximately $205,000 and $236,000, 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 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 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 expenses consists primarily of television advertising, Internet (on-line) 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 costs are expensed when the related catalog and postcards are produced, distributed or superseded.

Accounting for income taxes

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales	59.2	60.3	60.4	61.2

Gross profit	40.8	39.7	39.6	38.8
Operating expenses:				
General and administrative	12.8	11.8	10.2	9.9
Advertising	15.2	12.4	16.5	16.3
Depreciation and amortization	0.4	0.5	0.3	0.4
Total operating expenses	28.4	24.7	27.0	26.6
Income from operations	12.4	15.0	12.6	12.2
Total other income	1.3	1.0	1.0	0.6
Income before provision for income taxes	13.7	16.0	13.6	12.8
Provision for income taxes	4.9	5.7	5.0	4.5
Net income	8.8 %	10.3 %	8.6 %	8.3 %

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Three Months Ended December 31, 2006 Compared With Three Months Ended December 31, 2005, and Nine Months Ended December 31, 2006 Compared With Nine Months Ended December 31, 2005

Sales

Sales increased by approximately $5,462,000, or 21.1%, to approximately $31,352,000 for the quarter ended December 31, 2006, from approximately $25,890,000 for the quarter ended December 31, 2005. For the nine months ended December 31, 2006, sales increased by approximately $17,663,000, or 16.3%, to approximately $125,838,000 compared to sales of approximately $108,175,000 for the nine months ended December 31, 2005. The increase in sales for the three and nine months ended December 31, 2006 can be primarily attributed to increased retail reorders and new orders, offset by decreased wholesale sales.

The Company has committed certain dollar 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 $3,969,000, or 21.9%, to approximately $22,066,000 for the three months ended December 31, 2006, from approximately $18,097,000 for the three months ended December 31, 2005. Retail reorder sales have increased by approximately $17,364,000, or 26.0%, to approximately $84,075,000 for the nine months ended December 31, 2006, from approximately $66,711,000 for the nine months ended December 31, 2005. Retail new order sales have increased by approximately $1,958,000, or 27.0%, to approximately $9,214,000 for the three months ended December 31, 2006, from approximately $7,256,000 for the three months ended December 31, 2005. Retail new order sales have increased by approximately $2,841,000, or 7.4%, to approximately $41,228,000 for the nine months ended December 31, 2006, from approximately $38,387,000 for the nine months ended December 31, 2005. Wholesale sales have decreased by approximately $465,000, or 86.5%, to approximately $72,000 for the three months ended December 31, 2006, from approximately $537,000 for the three months ended December 31, 2005. Wholesale sales have decreased by approximately $2,542,000, or 82.6%, to approximately $535,000 for the nine months ended December 31, 2006, from approximately $3,077,000 for the nine months ended December 31, 2005. The decrease in wholesale sales for the three and nine months ended December 31, 2006 compared to the same period in the prior year can be attributed to a strategic business decision to focus more on retail customers and limit wholesale sales. We may continue to limit our wholesale sales in the future to concentrate our business on retail sales.

The Company acquired approximately 130,000 new customers for the quarter ended December 31, 2006, compared to approximately 105,000 new customers for the same period in the prior year. For the nine months ended December 31, 2006 the Company acquired approximately 549,000 new customers, compared to approximately 530,000 new customers for the same period in the prior year. The increase in new customers acquired for the three and nine months ended December 31, 2006 compared to the three and nine months ended December 31, 2005 can be attributable to increased advertising spending in the quarter ending December 31, 2006.

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%, respectively.

Cost of sales

Cost of sales increased by approximately $2,949,000, or 18.9%, to approximately $18,563,000 for the quarter ended December 31, 2006, from approximately $15,614,000 for the quarter ended December 31, 2005. For the nine months ended December 31, 2006, cost of sales increased by approximately $9,814,000, or 14.8%, to approximately $76,003,000 compared to cost of sales of approximately $66,189,000 for the nine months ended December 31, 2005. The increase in cost of sales for the three and nine months ended December 31, 2006 is directly related to the increase in sales. As a percent of sales, the cost of sales was 59.2% and 60.3% for the three months ended December 31, 2006 and 2005, respectively, and for the nine months ended December 31, 2006 and 2005 cost of sales was 60.4% and 61.2%, respectively. The cost of sales percentage decreases can be mainly attributed to a decrease in our wholesales sales, which had a higher cost of sales percentage, and a shift in our product mix to higher margin items.

Gross profit

Gross profit increased by approximately $2,513,000, or 24.4%, to approximately $12,789,000 for the quarter ended December 31, 2006, from approximately $10,276,000 for the quarter ended December 31, 2005. For the nine months ended December 31, 2006, gross profit increased by approximately $7,850,000, or 18.7%, to approximately $49,836,000 compared to gross profit of approximately $41,986,000 for the nine months ended December 31, 2005. Gross profit as a percentage of sales was 40.8% and 39.7% for the three months ended December 31, 2006 and 2005, respectively, and for the nine months ended December 31, 2006 and 2005 gross profit as a percentage of sales was 39.6% and 38.8%, respectively. The gross profit percentage increases can mainly be attributed to a decrease in our wholesale sales, which had a lower gross profit percentage, and a shift in our product mix to higher margin items.

General and administrative expenses

General and administrative expenses increased by approximately $962,000, or 31.4%, to approximately $4,023,000 for the quarter ended December 31, 2006, from approximately $3,061,000 for the quarter ended December 31, 2005. For the nine months ended December 31, 2006, general and administrative expenses increased by approximately $2,070,000, or 19.3%, to approximately $12,792,000 compared to general and administrative expenses of approximately $10,722,000 for the nine months ended December 31, 2005. The increase in general and administrative expenses for the three months ended December 31, 2006 was primarily due to the following: a $739,000 increase to payroll expenses, with $223,000 of the increase due to the recognition of stock option compensation expense during the quarter 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 the Company's growth; a $84,000 increase to insurance expenses due to increased premium on general liability policy; a $70,000 increase to bank service and credit card fees which can be directly attributed to increased sales in the quarter; and a $69,000 increase in other expenses which includes mainly office expenses, property expenses, telephone expenses, professional fees and bad debt expense.

The increase in general and administrative expenses for the nine months ended December 31, 2006 was primarily due to the following: a $1,588,000 increase to payroll expenses, with $669,000 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 the Company's growth; a $357,000 increase to bank service and credit card fees which can be directly attributed to increased sales in the period; a $172,000 increase to property expenses relating to additional rent due to our warehouse expansion; a $100,000 increase to telephone expenses resulting from receiving one-time usage credits in the same period during the prior year; a $95,000 increase in office expenses, and a $100,000 increase in other expenses which includes insurance expenses, bad debt expense, travel and licenses expenses. Offsetting the increase was a $265,000 one-time charge relating to state/county sales tax, which was not collected on behalf of our customers in the first quarter of fiscal 2006, and a $77,000 decrease to professional fees, which was related to a reduction in legal fees.

Advertising expenses

Advertising expenses increased by approximately $1,582,000, or 49.6%, to approximately $4,771,000 for the quarter ended December 31, 2006, from approximately $3,189,000 for the quarter ended December 31, 2005. For the nine months ended December 31, 2006, advertising expenses increased by approximately $3,055,000, or 17.2%, to approximately $20,771,000 compared to advertising expenses of approximately $17,716,000 for the nine months ended December 31, 2005. As a percentage of sales, advertising expense was 15.2% and 12.4% for the three months ended December 31, 2006 and 2005, respectively, and 16.5% and 16.3% for the nine months ended December 31, 2006 and 2005, respectively. The advertising costs of acquiring a new customer, defined as total advertising costs divided by the number of new customers acquired, for the quarter ended December 31, 2006 was $37, compared to $30 for the same period the prior year, and for the nine months ended December 31, 2006, the advertising cost of acquiring a new customer was $38 compared to $33 for the same period the prior year. The increase in the advertising costs of acquiring a new customer may be attributed to increased advertising spending and increased price competition from both veterinarians and retailers of pet medications. The Company estimates advertising as a percentage of sales to average between 16.0% and 17.0% for the year ending March 31, 2007. This is a 1 % increase to our original estimate. However, the advertising percentage will fluctuate quarter to quarter due to seasonality and advertising availability.

Other income

Other income increased by approximately $159,000 to approximately $424,000 for the quarter ended December 31, 2006, from approximately $265,000 for the quarter ended December 31, 2005. For the nine months ended December 31, 2006, other income increased by approximately $609,000 to approximately $1,248,000 compared to other income of approximately $639,000 for the nine months ended December 31, 2005. The increase to other income for the three and nine months ended December 31, 2006 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 term investment accounts, and to advertising revenue generated from our website.

Provision for income taxes

For the quarters ended December 31, 2006 and 2005, the Company recorded an income tax provision for approximately $1,535,000 and $1,484,000, respectively, which resulted in an effective tax rate of 35.8% and 35.7%, respectively. For the nine months ended December 31, 2006 and 2005, the Company recorded an income tax provision of approximately $6,306,000 and $4,867,000, respectively, which resulted in an effective tax rate of 36.8% and 35.3%, respectively.

Liquidity and Capital Resources

The Company's working capital at December 31, 2006 and March 31, 2006 was $46,594,000 and $34,969,000, respectively. The $11,625,000 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 $15,111,000 and $13,549,000 for the nine months ended December 31, 2006 and 2005, respectively. Net cash used in investing activities was $824,000 and $250,000 for the nine months ended December 31, 2006 and 2005, respectively. The $574,000 increase can be attributed to increased property and equipment additions to further the Company's growth, the addition of back-up infrastructure and an upgrade to its e-commerce platform during the period. Net cash provided by financing activities was $666,000 and $661,000 for the nine months ended December 31, 2006 and 2005, respectively.

The Company had financed certain equipment acquisitions with capital leases. As of December 31, 2006 and 2005, the Company had no outstanding lease commitments except for the lease for its executive offices and warehouse. The Company's sources of working capital include cash from operations and the exercise of stock options. For the remainder of fiscal 2007, the Company has approximately $400,000 planned for capital expenditures, the majority of which will be used to upgrade its e-commerce platform, and 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 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 on terms acceptable to the Company. 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," "plans," "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. At December 31, 2006, 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.

Item 4. 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-15 promulgated under the Securities Exchange Act of 1934, as amended) as of the quarter ended December 31, 2006, 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 1A. Risk Factors

Our operations and financial results are subject to various risks and uncertainties that could adversely affect our business, financial condition, results of operations, and trading price of our common stock. Please refer to our annual report on Form 10-K for fiscal year 2006 for additional information concerning these and other uncertainties that could negatively impact the Company.

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.

None

Item 5. Other Information.

None

Item 6. Exhibits

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 December 31, 2006, 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 December 31, 2006, 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 December 31, 2006, Commission File No. 000-28827).

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SIGNATURES

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

PETMED EXPRESS, INC.
(The "Registrant")

Date: February 2, 2007

By: /s/ Menderes Akdag

Menderes Akdag

Chief Executive Officer and President
(principal executive officer)

By: /s/ Bruce S. Rosenbloom

Bruce S. Rosenbloom

Chief Financial Officer
(principal financial and accounting officer)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

PETMED EXPRESS, INC.

FORM 10-Q

FOR THE QUARTER ENDED:

DECEMBER 31, 2006

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 Act of 2002	1	**
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	**

** Filed herewith