PETMED EXPRESS INC
Form 10-Q
October 30, 2018

UNITED STATES

securities and exchange commission

Washington D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

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)

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

420 South Congress Avenue, Delray Beach, Florida 33445

(Address of principal executive offices, including zip code)

(561) 526-4444

(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
(Do not check if smaller reporting company)	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 20,673,921 Common Shares, $.001 par value per share at October 30, 2018.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

PETMED EXPRESS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except for per share amounts)

	September 30, 2018 (Unaudited)	**March 31, 2018**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 87,132	$ 77,936
Accounts receivable, less allowance for doubtful accounts of $37 and $35, respectively	1,786	2,292
Inventories - finished goods	28,616	23,337
Prepaid expenses and other current assets	976	882
Prepaid income taxes	618	788
Total current assets	119,128	105,235
Noncurrent assets:		
Property and equipment, net	28,083	28,741
Intangible assets	860	860
Total noncurrent assets	28,943	29,601
Total assets	$ 148,071	$ 134,836
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 14,278	$ 15,274
Accrued expenses and other current liabilities	2,767	2,835
Total current liabilities	17,045	18,109
Deferred tax liabilities	1,185	996
Total liabilities	18,230	19,105

Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $.001 par value, 5,000 shares authorized; 3 convertible shares issued and outstanding with a liquidation preference of $4 per share	9	9
Common stock, $.001 par value, 40,000 shares authorized; 20,674 and 20,601 shares issued and outstanding, respectively	21	21
Additional paid-in capital	10,881	9,381
Retained earnings	118,930	106,320
Total shareholders' equity	129,841	115,731
Total liabilities and shareholders' equity	$ 148,071	$ 134,836

See accompanying notes to condensed consolidated financial statements.

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PETMED EXPRESS, INC. AND SUBSIDIARIES

condensed consolidated statementS of COMPREHENSIVE INCOME

(In thousands, except for per share amounts)(Unaudited)

	Three Months Ended		Six Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Sales	$71,396	$66,711	$158,786	$146,368
Cost of sales	46,141	43,232	103,577	95,424
Gross profit	25,255	23,479	55,209	50,944
Operating expenses:				
General and administrative	6,200	6,178	13,134	12,404
Advertising	5,300	4,526	12,007	10,818
Depreciation	552	527	1,108	1,058
Total operating expenses	12,052	11,231	26,249	24,280
Income from operations	13,203	12,248	28,960	26,664
Other income:				
Interest income, net	428	143	807	226
Other, net	255	249	572	490
Total other income	683	392	1,379	716
Income before provision for income taxes	13,886	12,640	30,339	27,380
Provision for income taxes	3,134	3,880	7,005	9,344
Net income	$10,752	$8,760	$23,334	$18,036
Comprehensive income	$10,752	$8,760	$23,334	$18,036
Net income per common share:				
Basic	$0.53	$0.43	$1.14	$0.89
Diluted	$0.52	$0.43	$1.14	$0.88
Weighted average number of common shares outstanding:				
Basic	20,463	20,349	20,436	20,321
Diluted	20,520	20,437	20,485	20,442

Cash dividends declared per common share	$0.27	$0.20	$0.52	$0.40

See accompanying notes to condensed consolidated financial statements.

PETMED EXPRESS, INC. AND SUBSIDIARIES

condensed consolidated statementS of cash flows

(In thousands)(Unaudited)

	Six Months Ended September 30,	
	2018	**2017**
Cash flows from operating activities:		
Net income	$23,334	$18,036
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,108	1,058
Share based compensation	1,500	1,146
Deferred income taxes	189	216
Bad debt expense	49	46
(Increase) decrease in operating assets and increase (decrease) in liabilities:		
Accounts receivable	457	(250)
Inventories - finished goods	(5,279)	(2,777)
Prepaid income taxes	170	-
Prepaid expenses and other current assets	(94)	(87)
Accounts payable	(996)	(4,845)
Income taxes payable	-	5,349
Accrued expenses and other current liabilities	(36)	411
Net cash provided by operating activities	20,402	18,303
Cash flows from investing activities:		
Purchases of property and equipment	(450)	(350)
Net cash used in investing activities	(450)	(350)
Cash flows from financing activities:		
Dividends paid	(10,756)	(8,240)
Net cash used in financing activities	(10,756)	(8,240)
Net increase in cash and cash equivalents	9,196	9,713
Cash and cash equivalents, at beginning of period	77,936	58,730
Cash and cash equivalents, at end of period	$87,132	$68,443
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$6,645	$3,780
Dividends payable in accrued expenses	$207	$202

See accompanying notes to condensed consolidated financial statements.

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, health products, and supplies 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 advertising campaigns, which aim to increase the recognition of the “1-800-PetMeds” brand name, and “PetMeds” family of trademarks, increase traffic on its website at www.1800petmeds.com, acquire new customers, and maximize repeat purchases. The majority of the Company’s sales are to residents in the United States. The Company’s corporate headquarters and distribution facility are located in Delray Beach, Florida. The Company’s fiscal year end is March 31, and references herein to Fiscal 2019 or Fiscal 2018 refer to the Company's fiscal years ending March 31, 2019 and 2018, 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 at September 30, 2018, the Statements of Comprehensive Income for the three and six months ended September 30, 2018 and 2017, and Cash Flows for the six months ended September 30, 2018 and 2017. The results of operations for the three and six months ended September 30, 2018 are not necessarily indicative of the operating results expected for the fiscal year ending March 31, 2019. 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, 2018. 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.

Fair Value of Financial Instruments

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

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-09, “Revenue from Contracts with Customers” (“ASC 606”). ASC 606 clarifies the accounting for revenue arising from contracts with customers and specifies the disclosures that an entity should include in its financial statements. During 2016, the FASB issued certain amendments to the standard relating to the principal versus agent guidance, accounting for licenses of intellectual property and identifying performance obligations as well as the guidance on transition, collectability, noncash consideration and the presentation of sales and other similar taxes. The Company adopted ASC 606 using the modified retrospective method on April 1, 2018. Therefore, the comparative financial information has not been restated and continues to be reported under the accounting standards in effect for those periods.

The Company evaluated only contracts not completed at the date of initial application for each of the five steps in ASC 606, which are as follows: 1) Identify the contract with the customer; 2) Identify the performance obligations in the contract; 3) Determine the transaction price; 4) Allocate the transaction price to the performance obligations; and 5) Recognize revenue when (or as) performance obligations are satisfied. The effect of initially applying ASC 606 did not result in an opening balance adjustment to retained earnings or any other Balance Sheet accounts because the Company: (1) identified similar performance obligations under ASC 606 as compared with deliverables and separate units of account previously identified; (2) determined the transaction price to be consistent; and (3) concluded that revenue is recorded at the same point in time, upon shipment under both ASC 605 and ASC 606. Additionally, the Company concluded that the accounting for fulfillment costs or costs incurred to obtain a contract is unchanged by the adoption of ASC 606. The adoption of ASC 606 did not require significant changes in our internal controls and procedures over financial reporting and disclosures. However, we made enhancements to existing internal controls and procedures to ensure compliance with the new guidance.

In February 2016, the FASB issued guidance on leases which supersedes the current lease guidance. The core principle requires lessees to recognize the assets and liabilities that arise from nearly all leases in the statement of financial position. Accounting applied by lessors will remain largely consistent with previous guidance. Additional changes are expected to align lessor accounting with the revised lessee model and the FASB’s revenue recognition guidance. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact of this standard on its consolidated financial statements. We do not expect the standard to have a material impact on our consolidated financial statements.

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

Note 2: Revenue Recognition

The Company generates revenue by selling pet medication products and pet supplies. Certain pet supplies offered on the Company’s website are drop shipped to customers. The Company considers itself the principal in the arrangement because the Company controls the specified good before it is transferred to the customer. Revenue contracts contain one performance obligation, which is delivery of the product; customer care and support is deemed not to be a material right in the contract. The transaction price is adjusted at the date of sale for any applicable sales discounts and an estimate of product returns, which are estimated based on historical patterns, however not considered a key judgment. There are no amounts excluded from variable consideration. Revenue is recognized when control transfers to the customer at the point in time in which shipment of the product occurs. This key judgment is determined as the shipping point represents the point in time in which the Company has a present right to payment, title has transferred to the customer, and the customer has assumed the risks and rewards of ownership. Outbound shipping and handling fees are an accounting policy election, and are included in sales as the Company considers itself the principal in the arrangement given responsibility for supplier selection and discretion over pricing. Shipping costs associated with outbound freight after control over a product has transferred to a customer are an accounting policy election and are accounted for as fulfillment costs and are included in cost of sales.

The Company disaggregates revenue in the following two categories: (1) Reorder revenue vs new order revenue, and (2) Internet revenue vs. contact center revenue. The following table illustrates revenue by various classifications:

Three Months Ended September 30,

Revenue (In thousands)	**2018**	**%**	**2017**	**%**	**$ Variance**	**% Variance**
Reorder Sales	$60,979	85.4 %	$55,065	82.5 %	$ 5,914	10.7 %
New Order Sales	10,417	14.6 %	11,646	17.5 %	(1,229)	-10.6 %
Total Net Sales	$71,396	100.0%	$66,711	100.0%	$ 4,685	7.0 %
Internet Sales	$60,306	84.5 %	$56,169	84.2 %	$ 4,137	7.4 %
Contact Center Sales	11,090	15.5 %	10,542	15.8 %	548	5.2 %
Total Net Sales	$71,396	100.0%	$66,711	100.0%	$ 4,685	7.0 %

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Six Months Ended September 30,

Sales (In thousands)	**2018**	**%**	**2017**	**%**	**$ Variance**	**% Variance**
Reorder Sales	$132,493	83.4 %	$119,532	81.7 %	$ 12,961	10.8 %
New Order Sales	26,293	16.6 %	26,836	18.3 %	(543)	-2.0 %
Total Net Sales	$158,786	100.0%	$146,368	100.0%	$ 12,418	8.5 %
Internet Sales	$134,625	84.8 %	$122,817	83.9 %	$ 11,808	9.6 %
Contact Center Sales	24,161	15.2 %	23,551	16.1 %	610	2.6 %
Total Net Sales	$158,786	100.0%	$146,368	100.0%	$ 12,418	8.5 %

The majority of the Company’s sales are paid by credit cards and the Company usually receives the cash settlement in two to three banking days. Credit card sales minimize the accounts receivable balances relative to sales. The Company had no material contract asset or contract liability balances as of September 30, 2018 or March 31, 2018.

Note 3: Net Income Per Share

In accordance with the provisions of Accounting Standards Codification (ASC) Topic 260 (“*Earnings Per Share*”) basic net income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income per common share includes the dilutive effect of potential restricted stock and the effects of the potential conversion of preferred shares, calculated using the treasury stock method. Unvested restricted stock and convertible preferred shares issued by the Company represent the only dilutive effect reflected in the 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 (in thousands, except for per share amounts):

	Three Months Ended September 30,		**Six Months Ended September 30,**	
	2018	**2017**	**2018**	**2017**
Net income (numerator):				

Net income	$10,752	$8,760	$23,334	$18,036
Shares (denominator):				
Weighted average number of common shares outstanding used in basic computation	20,463	20,349	20,436	20,321
Common shares issuable upon vesting of restricted stock	47	78	39	111
Common shares issuable upon conversion of preferred shares	10	10	10	10
Shares used in diluted computation	20,520	20,437	20,485	20,442
Net income per common share:				
Basic	$0.53	$0.43	$1.14	$0.89
Diluted	$0.52	$0.43	$1.14	$0.88

For the three and six months ended September 30, 2018, 46,868 shares of common restricted stock were excluded from the computations of diluted net income per common share, as their inclusion would have had an anti-dilutive effect on diluted net income per common share. For the three and six months ended September 30, 2017, 79,200 shares of common restricted stock were excluded from the computations of diluted net income per common share, as their inclusion would have had an anti-dilutive effect on diluted net income per common share.

Note 4: Stock-Based Compensation

The Company records compensation expense associated with restricted stock in accordance with ASC Topic 718 (*"Share Based Payment"*) (ASU 2016-09). The compensation expense related to all of the Company's stock-based compensation arrangements is recorded as a component of general and administrative expenses. The Company had 972,175 restricted common shares issued under the 2006 Employee Equity Compensation Restricted Stock Plan ("2006 Employee Plan"), 85,600 restricted common shares issued under the 2016 Employee Equity Compensation Restricted Stock Plan ("2016 Employee Plan" and collectively referred to with the 2006 Employee Plan as the "Employee Plans"), 272,000 restricted common shares issued under the 2006 Outside Director Equity Compensation Restricted Stock Plan ("2006 Director Plan"), and 97,500 restricted common shares issued under the 2015 Outside Director Equity Compensation Restricted Stock Plan ("2015 Director Plan", and collectively referred to with the 2006 Director Plan as the "Director Plans") at September 30, 2018, all shares of which were issued subject to a restriction or forfeiture period that lapses ratably on the first, second, and third anniversaries of the date of grant, and the fair value of which is being amortized over the three-year restriction period.

In July 2018, the Board of Directors approved the issuance of 47,450 restricted shares to certain employees of the Company under the 2016 Employee Plan, with a fair value of $35.43 per share. In July 2018, the Board of Directors approved the issuance of 37,500 restricted shares to directors of the Company under the 2015 Director Plan, with a fair value of $35.43 per share. For the quarters ended September 30, 2018 and 2017, the Company recognized $781,000 and $652,000, respectively, of compensation expense related to the Employee and Director Plans. For the six months ended September 30, 2018 and 2017, the Company recognized $1.5 million and $1.1 million, respectively, of compensation expense related to the Employee and Director Plans. At September 30, 2018 and 2017, there was $5.5 million and $6.0 million of unrecognized compensation cost related to the non-vested restricted stock awards, respectively, which is expected to be recognized over the next three years. At September 30, 2018 and 2017, there were approximately 191,000 and 236,000 non-vested restricted shares, respectively.

Note 5: Fair Value

The Company carries various assets and liabilities at fair value in the Condensed Consolidated Balance Sheets. Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. ASC Topic 820 ("Fair Value Measurements") establishes a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 - Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. At September 30, 2018, the Company had invested the majority of its $87.1 million cash and cash equivalents balance in money market funds which are classified within level 1.

Note 6: Commitments and Contingencies

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. The Company initiates litigation to protect its trade or service marks. There can be no assurance that the Company will be successful in protecting its trade or service marks. Legal costs related to the above matters are expensed as incurred.

Note 7: Changes in Shareholders’ Equity and Comprehensive Income:

Changes in shareholders’ equity for the six months ended September 30, 2018 are summarized below (in thousands):

	Additional Paid-In Capital	**Retained Earnings**
Beginning balance at March 31, 2018:	$ 9,381	$ 106,320
Share based compensation	1,500	-
Dividends declared	-	(10,724)
Net income	-	23,334
Ending balance at September 30, 2018:	$ 10,881	$ 118,930

No shares of treasury stock were purchased or retired in the six months ended September 30, 2018 and 2017.

Note 8: Income Taxes

For the quarters ended September 30, 2018 and 2017, the Company recorded an income tax provision of approximately $3.1 million and $3.9 million, respectively, and for the six months ended September 30, 2018 and 2017, the Company recorded an income tax provision of approximately $7.0 million and $9.3 million, respectively. The effective tax rate for the quarter ended September 30, 2018 was approximately 22.6%, compared to 30.7% for the quarter ended September 30, 2017. The effective tax rate for the six months ended September 30, 2018 was approximately 23.1%, compared to 34.1% for the six months ended September 30, 2017. The decrease to the income tax provision and the effective rate for the three and six months ended September 30, 2018, are related to a decrease in the federal tax rate from 35.0% to 21.0% pursuant to the Tax Cuts and Jobs Act of 2017.

Note 9: Subsequent Events

On October 22, 2018 our Board of Directors declared a quarterly dividend of $0.27 per share. The Board established a November 5, 2018 record date and a November 16, 2018 payment date. Based on the outstanding share balance as of

October 31, 2018 the Company estimates the dividend payable to be approximately $5.6 million.

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 Global Select Market under the symbol "PETS." The Company began selling pet medications and other pet health products in September 1996. In March 2010, the Company started offering for sale additional pet supplies on its website, and these items are drop shipped to customers by third party vendors. Presently, the Company's product line includes approximately 3,000 of the most popular pet medications, health products, and supplies for dogs and cats.

The Company markets its products through national advertising campaigns which aim to increase the recognition of the "1-800-PetMeds" brand name, and "PetMeds" family of trademarks, increase traffic on its website at www.1800petmeds.com, acquire new customers, and maximize repeat purchases. Approximately 85% of all sales were generated via the Internet for the quarter ended September 30, 2018, compared to 84% for the quarter ended September 30, 2017. The Company's sales consist of products sold mainly to retail consumers. The three-month average purchase was approximately $87 and $85 per order for the quarters ended September 30, 2018 and 2017, respectively, and the six-month average purchase was approximately $89 and $86 per order for the six months ended September 30, 2018 and 2017, 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, and income taxes. 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 and pet supplies. Certain pet supplies offered on the Company's website are drop shipped to customers. The Company considers itself the principal in the arrangement because the Company controls the specified good before it is transferred to the customer. Revenue contracts contain one performance obligation, which is delivery of the product; customer care and support is deemed not to be a material right to the contract. The transaction price is adjusted at the date of sale for any applicable sales discounts and an estimate of product returns, which are estimated based on historical patterns, however this is not considered a key judgment. There are no amounts excluded from variable consideration. Revenue is recognized when control transfers to the customer at the point in time in which shipment of the product occurs. This key judgment is determined as the shipping point represents the point in time in which the Company has a present right to payment, title has transferred to the customer, and the customer has assumed the risks and rewards of ownership.

Outbound shipping and handling fees are an accounting policy election, and are included in sales as the Company considers itself the principal in the arrangement given responsibility for supplier selection and discretion over pricing. Shipping costs associated with outbound freight after control over a product has transferred to a customer are an accounting policy election and are accounted for as fulfillment costs and 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 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. The allowance for doubtful accounts was approximately $37,000 at September 30, 2018 compared to $35,000 at March 31, 2018.

Valuation of inventory

Inventories consist of prescription and non-prescription pet medications and pet supplies that are available for sale and are priced at the lower of cost or market value using a weighted average cost method. The Company writes down its inventory for estimated obsolescence. The inventory reserve was approximately $72,000 at September 30, 2018 compared to $58,000 at March 31, 2018.

Advertising

The Company's advertising expense consists primarily of Internet marketing and direct mail/print advertising. Internet costs are expensed in the month incurred and direct mail/print advertising costs are expensed when the related catalogs, brochures, and postcards are produced, distributed, or superseded.

Accounting for income taxes

The Company accounts for income taxes under the provisions of ASC Topic 740 ("*Accounting for Income Taxes*"), which generally requires recognition of deferred tax assets and liabilities for the expected future tax benefits or consequences of events that have been included in the Consolidated Financial Statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting carrying values and the tax bases of assets and liabilities, and are measured by applying enacted tax rates and laws for the taxable years in which those differences are expected to reverse.

Results of Operations

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

	Three Months Ended September 30,		**Six Months Ended September 30,**	
	2018	**2017**	**2018**	**2017**

Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	64.6	64.8	65.2	65.2
Gross profit	35.4	35.2	34.8	34.8
Operating expenses:				
General and administrative	8.7	9.3	8.3	8.5
Advertising	7.4	6.8	7.6	7.4
Depreciation	0.8	0.8	0.7	0.7
Total operating expenses	16.9	16.9	16.6	16.6
Income from operations	18.5	18.3	18.2	18.2
Total other income	1.0	0.6	0.9	0.5
Income before provision for income taxes	19.5	18.9	19.1	18.7
Provision for income taxes	4.4	5.8	4.4	6.4
Net income	15.1 %	13.1 %	14.7 %	12.3 %

Three Months Ended September 30, 2018 Compared With Three Months Ended September 30, 2017, and Six Months Ended September 30, 2018 Compared With Six Months Ended September 30, 2017

Sales

Sales increased by approximately $4.7 million, or 7.0%, to approximately $71.4 million for the quarter ended September 30, 2018, from approximately $66.7 million for the quarter ended September 30, 2017. For the six months ended September 30, 2018, sales increased by approximately $12.4 million, or 8.5%, to approximately $158.8 million compared to $146.4 million for the six months ended September 30, 2017. The increase in sales for the three and six months ended September 30, 2018 was primarily due to increased reorder sales. The Company acquired approximately 117,000 new customers for the quarter ended September 30, 2018, compared to approximately 134,000 new customers for the same period the prior year. For the six months ended September 30, 2018 the Company acquired approximately 286,000 new customers, compared to 302,000 new customers for the six months ended September 30, 2017. The following chart illustrates sales by various sales classifications:

Three Months Ended September 30,						
Sales (In thousands)	**2018**	**%**	**2017**	**%**	**$ Variance**	**% Variance**
Reorder Sales	$60,979	85.4 %	$55,065	82.5 %	$ 5,914	10.7 %
New Order Sales	10,417	14.6 %	11,646	17.5 %	(1,229)	-10.6 %
Total Net Sales	$71,396	100.0%	$66,711	100.0%	$ 4,685	7.0 %
Internet Sales	$60,306	84.5 %	$56,169	84.2 %	$ 4,137	7.4 %
Contact Center Sales	11,090	15.5 %	10,542	15.8 %	548	5.2 %
Total Net Sales	$71,396	100.0%	$66,711	100.0%	$ 4,685	7.0 %

Six Months Ended September 30,						
Sales (In thousands)	**2018**	**%**	**2017**	**%**	**$ Variance**	**% Variance**
Reorder Sales	$132,493	83.4 %	$119,532	81.7 %	$ 12,961	10.8 %
New Order Sales	26,293	16.6 %	26,836	18.3 %	(543)	-2.0 %
Total Net Sales	$158,786	100.0%	$146,368	100.0%	$ 12,418	8.5 %

Internet Sales	$134,625	84.8 %	$122,817	83.9 %	$ 11,808	9.6 %
Contact Center Sales	24,161	15.2 %	23,551	16.1 %	610	2.6 %
Total Net Sales	$158,786	100.0%	$146,368	100.0%	$ 12,418	8.5 %

Going forward sales may be adversely affected due to increased competition and consumers giving more consideration to price. No guarantees can be made that sales will continue to grow in the future. 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 2018, the Company's sales were approximately 29%, 24%, 22%, and 25%, respectively.

Cost of sales

Cost of sales increased by approximately $2.9 million, or 6.7%, to approximately $46.1 million for the quarter ended September 30, 2018, from approximately $43.2 million for the quarter ended September 30, 2017. For the six months ended September 30, 2018, cost of sales increased by approximately $8.2 million, or 8.5%, to approximately $103.6 million compared to $95.4 million for the same period in the prior year. The increase in cost of sales is directly related to the increase in sales during the quarter and six months ended September 30, 2018. Cost of sales as a percent of sales was 64.6% and 64.8% for the quarters ended September 30, 2018 and 2017, respectively, and for both the six months ended September 30, 2018 and 2017 the cost of sales as a percent was 65.2%. The cost of sales percentage decrease for the quarter ended September 30, 2018 is mainly attributed to a product mix shift to higher margin items, offset by additional discounts given to customers to increase sales during the quarter ended September 30, 2018.

Gross profit

Gross profit increased by approximately $1.8 million, or 7.6%, to approximately $25.3 million for the quarter ended September 30, 2018, from approximately $23.5 million for the quarter ended September 30, 2017. For the six months ended September 30, 2018 gross profit increased by approximately $4.3 million, or 8.4%, to approximately $55.2 million, compared to $50.9 million for the same period in the prior year. The increase in gross profit is directly related to an increase in sales during the quarter and six months ended September 30, 2018. Gross profit as a percentage of sales was 35.4% and 35.2% for the three months ended September 30, 2018 and 2017, respectively, and for both the six months ended September 30, 2018 and 2017, gross profit was 34.8%. The gross profit percentage increase for the quarter ended September 30, 2018 is mainly attributed to a product mix shift to higher margin items, offset by additional discounts given to customers to increase sales during the quarter.

General and administrative expenses

General and administrative expenses for both quarters ended September 30, 2018 and 2017 was $6.2 million. General and administrative expenses as a percentage of sales was 8.7% and 9.3% for the quarters ended September 30, 2018 and 2017, respectively. The percentage decrease for the quarter ended September 30, 2018 can be attributed to an increase to sales. For the six months ended September 30, 2018 general and administrative expenses increased by $730,000, or 5.9%, to approximately $13.1 million from approximately $12.4 million for the six months ended September 30, 2017. The increase in general and administrative expenses for the six months ended September 30, 2018 was primarily due to the following: a $349,000 increase in payroll expenses related to increased sales and increased stock compensation expense; a $273,000 increase in bank service fees; a $85,000 increase in property expenses; and a $23,000 net increase in other expenses, which included professional fees, licenses, and travel expenses.

Advertising expenses

Advertising expenses increased by approximately $774,000, or 17%, to approximately $5.3 million for the quarter ended September 30, 2018, from approximately $4.5 million for the quarter ended September 30, 2017. For the six months ended September 30, 2018, advertising expenses increased by approximately $1.2 million, or 11%, to approximately $12.0 million compared to advertising expenses of approximately $10.8 million for the six months ended September 30, 2017. The increase in advertising expenses for the three and six months ended September 30, 2018 was intended to stimulate sales and acquire new customers. Increased advertising had a positive impact on reorder revenue. The advertising costs of acquiring a new customer, defined as total advertising costs divided by new customers acquired, increased to $45 for the quarter ended September 30, 2018, compared to $34 for the quarter ended September 30, 2017. For the six months ended September 30, 2018 and 2017 the advertising costs of acquiring a new customer were $42 and $36, respectively. The increases to customer acquisition costs for the quarter and six months ended September 30, 2018 was due to increased advertising costs. Advertising cost of acquiring a new customer can be impacted by the advertising environment, the effectiveness of our advertising creative, advertising spending, and price competition. Historically, the advertising environment fluctuates due to supply and demand. A more favorable advertising environment may positively impact future sales, whereas a less favorable advertising environment may negatively impact future sales.

As a percentage of sales, advertising expense was 7.4% and 6.8% for the quarters ended September 30, 2018 and 2017, respectively, and for the six months ended September 30, 2018 and 2017 advertising expense was 7.6% and 7.4%, respectively. The increase in advertising expense as a percentage of total sales for the quarter and six months ended September 30, 2018 can be attributed to increased advertising spend during the quarter. The Company currently anticipates advertising as a percentage of sales to be between approximately 7.0% and 8.0% for fiscal 2019. However, the advertising percentage will fluctuate quarter to quarter due to seasonality and advertising availability.

Depreciation

Depreciation expense increased by approximately $25,000 to approximately $552,000 for the quarter ended September 30, 2018, from approximately $527,000 for the quarter ended September 30, 2017. For both the six months ended September 30, 2018 and 2017 depreciation expense was approximately $1.1 million. The increase to depreciation expense for the quarter ended September 30, 2018 can be attributed to an increase in new property and equipment additions during the quarter.

Other income

Other income increased by approximately $291,000 to approximately $683,000 for the quarter ended September 30, 2018 from approximately $392,000 for the quarter ended September 30, 2017. For the six months ended September 30, 2018 other income increased by approximately $663,000 to approximately $1.4 million compared to approximately $716,000 for the same period in the prior year. The increase to other income for the quarter and six months ended September 30, 2018 is primarily related to increased interest income, with additional increases to rental and advertising revenue. Interest income may decrease in the future as the Company utilizes its cash balances on its share repurchase plan, with approximately $10.2 million remaining as of September 30, 2018, on any quarterly dividend payment, or on its operating activities.

Provision for income taxes

For the quarters ended September 30, 2018 and 2017, the Company recorded an income tax provision of approximately $3.1 million and $3.9 million, respectively, and for the six months ended September 30, 2018 and 2017, the Company recorded an income tax provision of approximately $7.0 million and $9.3 million, respectively. The effective tax rate for the quarter ended September 30, 2018 was approximately 22.6%, compared to 30.7% for the quarter ended September 30, 2017, and the effective tax rate for the six months ended September 30, 2018 was approximately 23.1% compared to 34.1% for the six months ended September 30, 2017. The decreases to the income tax provision and effective rate for the three and six months ended September 30, 2018, are directly related to a decrease in the federal tax rate from 35.0% to 21.0% pursuant to the Tax Cuts and Jobs Act of 2017. The decrease to the effective rate for three and six months ended September 30, 2018 can also be attributed to a $134,000 income tax benefit related to restricted stock compensation, which was recognized in the September quarter.

Liquidity and Capital Resources

The Company's working capital at September 30, 2018 and March 31, 2018 was $102.1 million and $87.1 million, respectively. The $15.0 million increase in working capital was primarily attributable to cash flow generated from operations, offset by dividends paid in the period. Net cash provided by operating activities was $20.4 million and $18.3 million for the six months ended September 30, 2018 and 2017, respectively. This increase is mainly attributed to an increase in net income offset by fluctuations in inventory, accounts payable, and income taxes payable during the period. Net cash used in investing activities was $450,000 for the six months ended September 30, 2018, compared to net cash used in investing activities of $350,000 for the six months ended September 30, 2017. This change in investing activities is related to increased property and equipment additions. Net cash used in financing activities was $10.8 million for the six months ended September 30, 2018, compared to $8.2 million for the same period in the prior year, which represented an increase in the dividend paid for the six months ended September 30, 2018.

At September 30, 2018, the Company had approximately $10.2 million remaining under the Company's share repurchase plan. Subsequent to September 30, 2018, on October 22, 2018 our Board of Directors declared a $0.27 per share dividend. The Board established a November 5, 2018 record date and a November 16, 2018 payment date. Depending on future market conditions the Company may utilize its cash and cash equivalents on the remaining balance of its current share repurchase plan, on dividends, or on its operating activities.

At September 30, 2018, the Company had no outstanding lease commitments. We are not currently bound by any long or short term agreements for the purchase or lease of capital expenditures. Any material amounts expended for capital expenditures would be the result of an increase in the capacity needed to adequately provide for any increase in our business. To date we have paid for any needed additions to our capital equipment infrastructure from working capital funds and anticipate this being the case in the future. Presently, we have approximately $600,000 forecasted for capital expenditures for the remainder of fiscal 2019, which will be funded through cash from operations. The Company's primary source of working capital is cash from operations. The Company presently has no need for alternative sources of working capital, and has no commitments or plans to obtain additional capital.

Off-Balance Sheet Arrangements

The Company had no off-balance sheet arrangements at September 30, 2018.

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," "PetMeds," "PetMed," "PetMeds.com," “1800PetMeds.com,” "PetMed.com," "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, and accounts payable. 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. Interest rates affect our return on excess cash and investments. At September 30, 2018, we had $87.1 million in cash and cash equivalents, a majority of our cash and cash equivalents are invested in money market funds and generate interest income based on prevailing interest rates. A significant change in interest rates would impact the amount of interest income generated from our excess cash and cash equivalents. It would also impact the market value of our investments. Our cash equivalents are subject to market risk, primarily interest rate and credit risk. Our cash equivalents are managed by a limited number of outside professional managers within investment guidelines set by our Board of Directors. Such guidelines include security type, credit quality, and maturity, and are intended to limit market risk by restricting our investments to high-quality debt instruments with both short and long term maturities. We do not hold any derivative financial instruments that could expose us to significant market risk. At September 30, 2018, we had no debt obligations.

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 September 30, 2018, 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 such that the information relating to our Company, including our consolidated subsidiaries, required to be disclosed by the Company in reports that it files or submits under the Exchange Act: (1) is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and (2) is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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 2018 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.

The Company did not make any sales of unregistered securities during the second quarter of Fiscal 2019.

Issuer Purchases of Equity Securities

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

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.*
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.*
32.1	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101.INS	XBRL Instance
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation
101.DEF	XBRL Taxonomy Extension Definition
101.LAB	XBRL Taxonomy Extension Labels

101.PREXBRL Taxonomy Extension Presentation

*Filed herewith.

**Furnished herewith.

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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: October 30, 2018

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)

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

PETMED EXPRESS, INC

FORM 10-Q

FOR THE QUARTER ENDED:

SEPTEMBER 30, 2018

EXHIBITS