

Petmed Express

(PETS- Price Target: \$17)
Recommendation: Buy

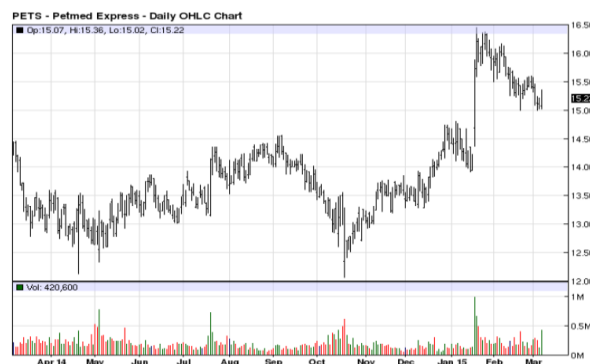
Div Yield: 4.5%
Total Return Objective: 17.0%
Required Return Ratio: 2.08x
Endogenous Return: 1.2%

S&P 500 Debt Rating: N/A
Headquarters: Florida



Cur Price: \$15.11
52 Wk Hi: \$16.45
52 Wk Lo: \$12.07
Mkt Cap (\$ Mil) \$303
Dil Shs Out: 20.2

ROIC: 23.19%
WACC: 8.17%
EVA (\$ Mil): \$10
Adj Beta: 1.01
G/B Score: 6



Quick Company Description

PetMed Express operates under the name 1-800-PetMeds, and is an prescription and over-the-counter online/e-tail pet pharmacy. The company derives 100% of its revenue in the United States.

Summary

This is a dull and boring company that lacks the thing that most investors seek: growth. PETS' overall revenue growth has been stagnant the last five years, and its contribution from new customers has been falling. However, what PetMeds does offer is a highly loyal customer base who will spend on prescriptions and products for their pets despite the state of the economy, and we expect that "same stores" growth to offset the lack of new customers. That makes this a good defensive name, with an attractive valuation and a 4.5% yield to boot. Owning a few no frills companies with simple business models that earn well in excess of their cost of capital and are priced below intrinsic value isn't a bad thing, especially in an overall U.S. stock market that we believe is trading well above historical multiples.

Key Investment Considerations

If You Want a Growth Story, This Ain't It - PetMed's revenue has been between \$228-\$238 million in each of the last five fiscal years. A big part of the problem is that it is difficult for PETS to add to its customer base (especially for its perscription business), as evidenced by the fact that sales from new customers has posted a 5-Yr CAGR of -7.6% since FY08. PETS does offer savings and convenience versus buying meds and supplies from veterinarians, but therein lies the rub: many vets aren't too wild about writing prescriptions that will reduce their own sales. Moreover, PETS receives 100% of its revenue from the United States, and we believe the PetMeds model may not work as well in other countries (lower medicine prices, different regulatory regimes), thereby limiting its growth upside from international expansion. However, we believe the customers PETS does have are loyal, and sales from this segment, which comprised 82% of total FY14 company sales, continue to grow. Overall, we are modelling sales to grow 2.0%-2.5%/yr long-term, which is essentially the rate of inflation.

No Debt, Asset Light Operating Model - No debt load to service + no real need for purchasing and maintaining fixed assets (i.e. no significant capex needs) = more cash to distribute to shareholders. Having no debt also means the company could take on some leverage in order to reduce their weighted average cost of capital, and possibly accelerate their stock buyback program at an after tax cost of debt that is lower than its current dividend yield.

Good Defensive Play- PETS derives more than 50% of its revenue from the sale of pet precription medicine, and the remainder from product sales, which we believe is a niche market. As such, we believe PETS' revenue would be relatively well shielded in the event of a downturn in the U.S. economy.

Favorable Trading Signals- PETS has experienced some weakness since missing its C3Q14 earnings by 10%, leaving the stock in oversold territory. Several other key technical indicators suggest that now is likely a good entry point into a stock that we believe is undervalued.

Valuation

- Our bottom up DCF suggests a \$17/sh. target price, while using a historical 15x overall market multiple in the terminal period in our DCF model leads to a similar \$16/sh valuation. Median enterprise value based multiples, which we prefer over those that are earnings based, also supports our \$17 target price.
- Dividend yield of 4.5% vs. 1.8% for the overall S&P 500.
- The lack of growth is no doubt a concern to investors, but this is still a company that earns returns on invested capital that are almost 20% higher than its cost of capital, and that offers an attractive dividend yield. That may not be in fashion now, but we think it will be when the S&P 500 Index, which is currently trading at one of its highest multiples in history, eventually corrects.

Other Considerations:

- Been buying back shares, and still has another \$5.6 million left to go on its current \$10.2 million share buyback program.
- Graham/Buffett score of 6 is relatively high.
- However, Beneish score is under 2.0, so that bears watching.

Risks

- PETS has no guaranteed supply of any medications, nor do they have any price guarantee. Four suppliers accounted for ~50% of their COGS in FY15.
- Their headquarters and distribution centers are located in two buildings in South Florida, so some hurricane risk.
- Only five sell-side analysts cover the stock, and there doesn't tend to be too much news flow on this name. No company presentation on the PetMed's Investor Relations website, so how much is management trying to sell the story to would be investors?

Company Descriptors

Fiscal YE:	March	Avg Operating Leverage:	-1.92
# Analysts:	5	Business Risk:	19%
% Institutional Holdings:	70%	Sales Variability:	2%
% Insider Holdings:	5%		

10% Customers None. Company is a direct retailer.

Revenue Breakdown By Segment

\$US Mil	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>% of Total</u>	<u>5-Yr CAGR</u>
Reorder Sales	156.9	177.8	184.3	187.0	184.8	191.2	81.9%	4.0%
New Order Sales	<u>62.5</u>	<u>60.5</u>	<u>47.3</u>	<u>51.3</u>	<u>43.0</u>	<u>42.2</u>	18.1%	-7.6%
TOTAL	219.4	238.3	231.6	238.3	227.8	233.4	100.0%	1.2%

Revenue Breakdown By Segment

\$US Mil	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>% of Total</u>	<u>5-Yr CAGR</u>
Internet Sales	143.3	162.8	165.5	178.8	176.0	184.4	79.0%	5.2%
Contact Center Sales	<u>76.1</u>	<u>75.5</u>	<u>66.2</u>	<u>59.5</u>	<u>51.8</u>	<u>49.0</u>	21.0%	-8.4%
TOTAL	219.4	238.3	231.6	238.3	227.8	233.4	100.0%	#DIV/0!

Revenue Breakdown By Segment

\$US Mil	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>% of Total</u>	<u>5-Yr CAGR</u>
Non-Prescription	151.4	162.0	148.3	145.3	134.4	128.4	55.0%	-3.2%
Prescription	65.8	73.9	81.1	90.5	91.1	102.7	44.0%	9.3%
Shipping/Handling	<u>2.2</u>	<u>2.4</u>	<u>2.3</u>	<u>2.4</u>	<u>2.3</u>	<u>2.3</u>	1.0%	1.2%
TOTAL	219.4	238.3	231.6	238.3	227.8	233.4	100.0%	1.2%

Revenue Breakdown By Geography

\$US Mil	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>% of Total</u>	<u>5-Yr CAGR</u>
USA	0.0	0.0	0.0	0.0	0.0	233.4	100.0%	#DIV/0!
TOTAL	0.0	0.0	0.0	0.0	0.0	233.4	100.0%	#DIV/0!

Valuation

Discounted Cash Flow Analysis			
Terminal Pd Method	Value	RRR	Terminal Period
			Multiple
Bottom Up	\$16.70	1.84x	15.8x
Hist Market	\$16.29	1.50x	15.0x
Min BU, 10Y P/E	\$16.70	1.84x	15.8x
ROIC=WACC	\$15.18	0.60x	12.7x

Bottom Up Sensitivity Analysis

	Terminal Period Growth Rate				
	0.8%	1.3%	1.8%	2.3%	2.8%
6.6%	\$17.38	\$18.17	\$19.14	\$20.32	\$21.82
7.1%	\$16.70	\$17.38	\$18.17	\$19.14	\$20.32
7.6%	\$16.13	\$16.70	\$17.38	\$18.17	\$19.14
8.1%	\$15.64	\$16.13	\$16.70	\$17.38	\$18.17
8.6%	\$15.21	\$15.64	\$16.13	\$16.70	\$17.38
9.1%	\$14.83	\$15.21	\$15.64	\$16.13	\$16.70
9.6%	\$14.49	\$14.83	\$15.21	\$15.64	\$16.13

FOR COMPLETE MODEL AND ASSUMPTIONS, PLEASE SEE APPENDIX

Minimum Valuation	
Net Cash/Sh	2.63
Graham Net-Nets	\$3.54
Tangible BV/Sh	3.61
Gordon Div Discount	#DIV/0!
Net Work Cap/Sh	\$0.23

Other	
PEG Ratio	6.23
Magic Formula Score:	33.9
Future G/Future EV:	28.1%
Street.com Rating:	A+

Price Implied Expecations	
Number of Years	0
1 Yr PIE	\$17.73
10 Yr PIE	\$18.21

Multiple Analysis									
Multiple	Current Value	Current Multiple	-----10-Year History-----			-----Imputed Price-----			Median
			Hi	Lo	Median	Hi	Low		
TTM P/E	\$0.86	17.6x	35.5x	11.3x	16.7x	\$30.56	\$9.68		\$14.40
NTM P/E	\$0.97	15.6x	0.0x	0.0x	0.0x	\$0.00	\$0.00		\$0.00
P/S	\$11.31	1.3x	3.0x	0.9x	1.6x	\$34.30	\$9.68		\$17.74
P/B	\$3.65	4.1x	11.3x	2.3x	4.3x	\$41.29	\$8.55		\$15.83
P/TBV	\$3.61	4.2x	11.4x	2.4x	4.4x	\$41.20	\$8.54		\$15.76
P/FCF	\$0.35	43.0x	44.1x	8.0x	18.3x	\$15.51	\$2.80		\$6.45
Average Price:									\$11.70
Median Price:									\$15.08
EV/S	\$228	1.1x	2.9x	0.6x	1.4x	\$35.70	\$8.94		\$17.96
EV/EBITDA	\$29	8.6x	21.5x	4.5x	8.7x	\$33.99	\$9.13		\$15.31
Average Price:									\$16.63
Median Price:									\$16.63
Average Price:									\$12.93
Median Price:									\$15.53

Growth Rate Analysis

Earnings Growth Rates

Consensus 5-Yr EPS Growth Rate:	2.5%
Prior 5-Yr EPS Growth Rate:	-1.3%
Sustainable Growth Rate:	4.5%
TTM P/E, Historical ERP Growth Rate	-1.3%
TTM P/E, Model 6% ERP Growth Rate	4.5%
Forward P/E, Historical ERP Growth Rate	34.9%
Forward P/E, Model 6% ERP Growth Rate	0.0%

EBIT Growth Rates

Consensus	Amount	CAGR
Last	28.22	
Year 1	29.60	4.9%
Year 2	32.20	6.8%
Year 3	#N/A N/A	#VALUE!
Year 4	0.00	-100.0%
Historical 5-Yr Regression		-8.8%
Historical 14-Yr Regression		20.7%
Implied by Reinvest Rate		34.9%
Used in DCF Terminal Pd		1.8%

Trading Signals

3 Mo Avg Volume (mil):	0.167
Float (mil):	17.52
Avg Vol/Shs Count:	1.0%
Net Short (mil):	5
Net Short As % of Float:	28.54%

10-Yr Hi 39.64%
 10-Yr Lo 6.98%
 10-Yr Median 23.72%

Insider Activity: 0 buys, 5 sells 5.5K

Earnings Surprises (Calendar Quarters)

	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Reported Pro Forma Earnings	0.21	0.23	0.23	0.25	0.19	0.24
Consensus Pro Forma Earnings	0.22	0.23	0.22	0.25	0.21	0.21
% Difference	-5%	0%	5%	0%	-10%	14%

At-the-Money Options Analysis

ATM Call Implied Vol: 27.8%

20 Day Historical Vol: 19.6%

Exp 1-Yr Price Range	
Low	High
\$10.91	\$19.31

Current Stock Price \$15.11
 ATM Strike Price \$15.00

Intrinsic Value Adjustment to Equate
 ATM Strike Price to Current Share Price

Options Expiration	ATM Call Price	ATM Put Price	Call Price	Put Price	Call/Put Ratio
Jan-15	\$0.10	\$0.00	(\$0.01)	\$0.00	#DIV/0!
Feb-15	\$0.20	\$1.15	\$0.09	\$1.15	0.08x
Mar-15	\$0.00	\$0.00	(\$0.11)	\$0.00	#DIV/0!
Jun-15	\$0.00	\$0.00	(\$0.11)	\$0.00	#DIV/0!
Jan-00	\$0.00	\$0.00	(\$0.11)	\$0.00	#DIV/0!
Jan-00	\$0.00	\$0.00	(\$0.11)	\$0.00	#DIV/0!

Sensitivity to Macroeconomic Indices (R² Over Last 60 Months)

Absolute Values

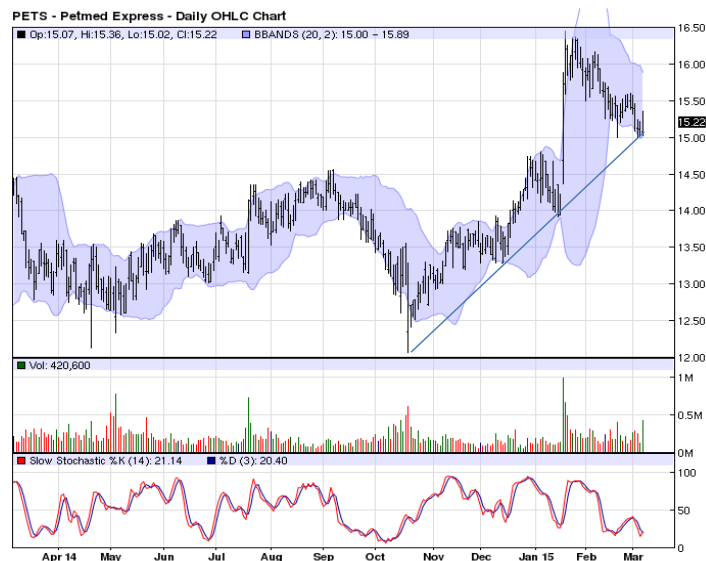
	10-Yr Treasury
PETS	50.9%
S&P 500 Index	0.0%

Logged Values

	10-Yr Treasury
PETS	47.9%
S&P 500 Index	0.0%

Technical Analysis

Tradingday.com Score: 56% Buy



Technical Analysis Notes

- Tradingday.com score is largely bullish.
- Slow stochastics are way oversold, Bollinger Band is at the bottom of its range, and the up trendline that has been in place since the stock bottomed last October recently held. All suggest a short-term price rise may be in order.
- Current support exists at the up trend-line at \$15.00, followed by the previous reactionary high at the \$14.75 level. Resistance is at the 52 week high of \$16.45.

Debt/Liquidity Analysis (\$ Mil)

Debt Ratios

S&P Rating	N/A
Altman Z Score	28.1
Health Grade	A
Total Debt	0.00
Total Cash/Equiv	52.6
TTM EBITDA	29.4
Qtrly Interest	0.00
Qtrly Operating Lease	0.20
Qtrly Take-Or-Pay	0.00
Qtrly Dividends	3.41
Current Assets	77.8
Current Liabilities	6.3
SH Equity	73.5
NPV Op Leases	0.90
NPV Take-or-Pay	0.00
Total Debt/Cap	0.0%
Adj Total Debt/Cap	1.2%
Total Debt/Cash	0.0x
Total Debt/EBITDA	0.0x
EBITDA/Int Exp	#DIV/0!
EBITDA/Fixed Charges	37.0x
Current Ratio	12.4x
(EBITDA-Int)/Divs	2.2x
(EBITDA-Fixed Chg)/Divs	2.1x
Payout Ratio	81%
Qty Interest As % of Revenue	0.0%
TTM Interest As % of Revenue	0.0%

Liquidity

Revolver	0
Undrawn Revolver	0
Cash on Hand	53
Liquidity	53
TTM CFO	8
TTM Capex (ex-acqs)	1
TTM FCF	7
Annual Cash Burn Coverage Ratio	-7.42x

Covenants

Debt/TTM EBITDA	0
Current	0.00x
TTM EBITDA/Fixed Charges	0
Current	37.0x

Historical Analysis

	Int Coverage	Debt/EBITDA	Debt/Cap	Div Pay Ratio
2013	#DIV/0!	0.0x	0.0%	73.1%
2012	#DIV/0!	0.0x	0.0%	185.7%
2011	#DIV/0!	0.0x	0.0%	66.0%
2010	#DIV/0!	0.0x	0.0%	51.9%
2009	#DIV/0!	0.0x	0.0%	26.4%
2008	#DIV/0!	0.0x	0.0%	0.0%
2007	#DIV/0!	0.0x	0.0%	0.0%
2006	#DIV/0!	0.0x	0.0%	0.0%
2005	#DIV/0!	0.0x	0.0%	0.0%
2004	12501.6x	0.0x	0.0%	0.0%
2003	614.1x	0.0x	0.5%	0.0%

Forward Projected Interest/Dividend Coverage

	2015	2016	2017	2018	2019	2020
Free Cash Flow	18	18	18	19	19	20
Estimated Interest Payments	0	0	0	0	0	0
Distributable Cash Flow	18	18	18	19	19	20
Estimated Dividends	14	14	14	14	14	14
Dividend Coverage	1.35x	1.34x	1.33x	1.37x	1.41x	1.43x

Individual Bonds

Issuer	Amt	Maturity	Coupon	Series	BB Rtg	Mty Type	Ask Px	YTM
0	0	1/0/00	0.00%	0	0	0	0	0.00%
0	0	1/0/00	0.00%	0	0	0	0	0.00%
0	0	1/0/00	0.00%	0	0	0	0	0.00%
0	0	1/0/00	0.00%	0	0	0	0	0.00%
0	0	1/0/00	0.00%	0	0	0	0	0.00%
0	0	1/0/00	0.00%	0	0	0	0	0.00%

Stock Buyback Analysis

Dividend Yield	4.50%	Marginal Tax Rate	37.0%
S&P Rating	N/A	After-Tax Debt Rate	1.81%
10-Yr Corporate Debt Yield for S&P Rating	2.87%	Div Yield Less After-Tax Debt Rate	2.69%
		Debt/Cap Ratio	0.00%

Forensic Accounting/Quarterly Operations Review

Beneish Score	-1.89
Options As % of Dil Shrs	1.1%
TTM Operating Margin	11.78%
Threshold Margin	1.57%

Y/Y % Changes in Key Quarterly Operating Variables

Qtr	Sales	A/R	Doubt Accts	Inv	A/P	Def Rev	Adver Exp	R&D
4Q14	-73%	-20%	-29%	-12%	-3%	#DIV/0!	-80%	#DIV/0!
3Q14	-57%	40%	20%	19%	-37%	#DIV/0!	-60%	#DIV/0!
2Q14	-2%	-36%	-92%	52%	-17%	#DIV/0!	-5%	#DIV/0!
1Q14	-5%	29%	-93%	13%	-11%	#DIV/0!	-5%	#DIV/0!
4Q13	273%	143%	-90%	31%	-33%	#DIV/0!	376%	#DIV/0!
3Q13	132%	-26%	-91%	-12%	19%	#DIV/0!	135%	#DIV/0!
2Q13	8%	4%	-43%	18%	41%	#DIV/0!	5%	#DIV/0!
1Q13	-9%	-13%	36%	21%	-2%	#DIV/0!	-19%	#DIV/0!
4Q12	-2%	-56%	8%	-28%	-2%	#DIV/0!	-15%	#DIV/0!

Management Effectiveness/Operations Momentum

Qtr	CCC	Gross Margin	EBIT Margin
4Q14	49	35.0%	15.6%
3Q14	48	32.1%	7.5%
2Q14	52	33.0%	10.8%
1Q14	76	36.2%	14.6%
4Q13	11	33.0%	11.4%
3Q13	11	33.2%	10.4%
2Q13	35	32.7%	10.1%
1Q13	54	35.6%	14.3%
4Q12	37	34.7%	14.5%

-----DuPont Analysis-----

Qtr	Net Prof Margin	Asset Turn	Fin Leverage	ROE
4Q14	7.5%	3.72x	0.85x	23.7%
3Q14	7.1%	5.96x	0.86x	36.2%
2Q14	7.2%	5.53x	1.15x	45.7%
1Q14	7.1%	5.58x	1.17x	46.4%
4Q13	7.1%	5.69x	1.18x	47.7%
3Q13	7.4%	4.03x	1.19x	35.3%
2Q13	7.7%	3.07x	1.11x	26.4%
1Q13	7.6%	2.90x	1.09x	23.8%
4Q12	7.1%	2.84x	1.07x	21.7%

Inventory Analysis

Qtr	Raw Materials	WIP	Finished Goods	Total	RM %	WIP %	FG %	Total %
4Q14	0.0	0.0	21.6	21.6	0.0%	0.0%	100.0%	100.0%
3Q14	0.0	0.0	20.5	20.5	0.0%	0.0%	100.0%	100.0%
2Q14	0.0	0.0	32.9	32.9	0.0%	0.0%	100.0%	100.0%
1Q14	0.0	0.0	35.7	35.7	0.0%	0.0%	100.0%	100.0%
4Q13	0.0	0.0	24.5	24.5	0.0%	0.0%	100.0%	100.0%
3Q13	0.0	0.0	17.3	17.3	0.0%	0.0%	100.0%	100.0%
2Q13	0.0	0.0	21.6	21.6	0.0%	0.0%	100.0%	100.0%
1Q13	0.0	0.0	31.6	31.6	0.0%	0.0%	100.0%	100.0%
4Q12	0.0	0.0	18.7	18.7	0.0%	0.0%	100.0%	100.0%

Key Historical Information

Year	Dil Shares	Divs/Sh.	ROIC	WACC	EVA	Revenue	COGS	GM %
2013	20.0	\$0.66	0.0%	0.0%	\$0	233	156	66.8%
2012	20.0	\$1.60	25.7%	9.0%	\$11	228	151	66.1%
2011	20.7	\$0.53	20.7%	8.6%	\$10	238	158	66.4%
2010	22.6	\$0.48	21.8%	8.2%	\$13	232	148	63.8%
2009	22.7	\$0.30	26.4%	7.8%	\$18	238	146	61.4%
2008	23.5	\$0.00	31.0%	8.8%	\$17	219	134	61.1%
2007	24.3	\$0.00	27.4%	10.4%	\$11	188	114	60.6%
2006	24.3	\$0.00	25.0%	13.6%	\$6	162	98	60.2%
2005	24.2	\$0.00	29.8%	13.3%	\$6	138	83	60.5%
2004	23.8	\$0.00	32.7%	11.0%	\$5	108	65	59.7%
2003	23.7	\$0.00	41.8%	6.6%	\$5	94	56	59.4%

Year	EBIT	EBIT %	Total Debt	Debt/Cap	ROE	YE Price	Rtd Earnings	R&D
2013	28	12.1%	0	0.0%	26.8%	\$15.80	69	\$0
2012	27	11.9%	0	0.0%	23.6%	\$10.08	64	\$0
2011	26	10.9%	0	0.0%	18.7%	\$8.93	81	\$0
2010	33	14.3%	0	0.0%	21.5%	\$14.68	97	\$0
2009	41	17.0%	0	0.0%	30.3%	\$14.19	94	\$0
2008	34	15.6%	0	0.0%	32.4%	\$14.01	75	\$0
2007	28	14.9%	0	0.0%	33.1%	\$9.61	59	\$0
2006	22	13.3%	0	0.0%	31.6%	\$10.61	39	\$0
2005	18	13.2%	0	0.0%	39.0%	\$11.26	24	\$0
2004	13	11.5%	0	0.0%	41.9%	\$6.06	12	\$0
2003	9	9.8%	0	0.5%	59.4%	\$5.72	4	\$0

Year	CFO	Capex	Acqs	Divestitures	FCF	NI	CFO/NI	FCF/NI
2013	14	0	0	0	13	18	75%	75%
2012	13	1	0	0	13	17	77%	74%
2011	20	1	0	0	20	17	122%	118%
2010	30	1	0	0	29	21	144%	141%
2009	28	1	0	0	27	26	106%	102%
2008	15	3	0	0	12	23	65%	51%
2007	19	1	0	0	19	20	97%	94%
2006	17	1	0	0	16	14	115%	108%
2005	10	1	0	0	10	12	85%	79%
2004	8	0	0	0	8	8	104%	102%
2003	1	1	0	0	0	6	19%	6%

Year	CFF	Goodwill Writeoffs	Dep As % of CFO	Def Taxes As % of CFO	Beneish Scores	Simple CapFlow	Total CapFlow	Modified Net/Nets Sh
2013	(13)	0	6.4%	-0.1%	-1.89	0%	0%	\$0.93
2012	(36)	0	8.2%	0.0%	-1.90	5%	5%	\$1.53
2011	(35)	0	6.9%	0.0%	-2.64	3%	3%	\$1.25
2010	(23)	0	4.6%	0.1%	-2.65	2%	2%	\$1.13
2009	(6)	0	4.8%	-0.1%	-1.49	4%	4%	\$1.36
2008	(16)	0	5.4%	0.2%	-1.50	21%	21%	\$1.23
2007	(9)	0	3.0%	-0.2%	-2.31	3%	3%	\$0.72
2006	1	0	3.2%	-0.1%	-2.32	6%	6%	\$0.59
2005	1	0	5.3%	-0.1%		7%	7%	\$0.60
2004	1	0	6.9%	0.0%		2%	2%	\$0.48
2003	2	0	49.7%	0.0%		67%	67%	\$0.42

Disclaimer

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PETMED EXPRESS

Three Stage Free Cash Flow to the Firm

	Yrs 1-5		Terminal Period	
	Stage 1 (Yrs 1-5)	From Output	Stage 2 (Yrs 6-10)	(From Below)
5-Yr Sales Growth Rate	2.5%	2.5%	2.4%	2.2%
EBIT Margin	12.5%	12.5%	12.4%	12.3%
Effective Tax Rate	37.0%	37.0%	37.0%	37.0%
Cash Tax Rate	37.0%	37.0%	37.0%	37.0%
Marginal Tax Rate	37.0%	37.0%	37.0%	37.0%
Cap Ex as % of Sales	0.5%	0.5%	0.5%	0.5%
Cap Ex Less Increase in Goodwill as a % of Sales	0.5%	0.5%	0.5%	0.5%
Working Cap As % of Sales	11.0%	11.0%	11.0%	11.0%
% Net Deferred Tax Liabilities as a % of Sales	0.0%	0.0%	0.0%	0.0%
% Other Net Liabilities as a % of Sales	0.0%	0.0%	0.0%	0.0%
Depreciation As % of Sales	0.5%	0.5%	0.5%	0.5%
Depreciation in Years	16.0	16.0	16.0	16.0
Inflation in Terminal Period (for CapEx)	-	-	2.2%	2.0%
Imputed Growth Pre-Tax Op. Inc. from Model	2.2%	2.2%	2.2%	1.8%
ected Growth in Pre-Tax Op. Inc. From 2012 ROE & 5-Yr Avg Reinvest Rate	-3.1%	-	-	-

According to Copeland, the 2 keys to valuation are the growth rate in operating income/earnings, and ROIC being greater than WACC. ROIC is the single most important value driver, but only focusing on ROIC can lead to harvesting behavior, leaving a company out of the race for long-term growth.

Should also at least think about the potential option value of the firm. That is, does a company have the option to expand, or to abandon a project early? These things shouldn't be included in the growth rate, but they could be added/subtracted from the DCF value.

Quick DCF Sensitivity Monitor

Bottom Up	\$16.70
Hist Market	\$16.29
Min BU, 10Y P/E	\$16.70
ROIC=WACC	\$15.18
Current Share Price	\$15.11

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025+
Check: Y/Y Chg in Sales	-2.0%	1.7%	3.2%	2.5%	2.5%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.2%
Check: Y/Y Chg in Pre-Tax Op. Income	0.5%	4.4%	1.4%	2.5%	2.5%	1.8%	2.4%	2.4%	2.4%	2.4%	2.4%	1.8%
Sales	233	229	233	240	246	252	258	264	271	277	284	290
Y/Y % Change	-2.0%	1.7%	3.2%	2.5%	2.5%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.2%
Pre-Tax Operating Profit (EBIT)	28	30	30	31	32	32	33	34	34	35	36	36
Operating Profit Margin	12.4%	12.7%	12.5%	12.5%	12.5%	12.4%	12.4%	12.4%	12.4%	12.4%	12.4%	12.3%
% Change Pre-Tax EBIT	-3.1%	0.5%	4.4%	1.4%	2.5%	2.5%	1.6%	2.4%	2.4%	2.4%	2.4%	1.8%
Tax Rate	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%
After Tax Earnings Before Interest & Taxes (EBIT*(1-t))	18	19	19	19	20	20	21	21	22	22	22	23
Add Back Imputed Interest on Operating Leases	0	0	0	-	-	-	-	-	-	-	-	-
Depreciation	1	1	1	1	1	1	1	1	1	1	1	1
Amortization	-	-	-	-	-	-	-	-	-	-	-	-
Increase in Deferred Tax Liabilities (Assets)	-	-	-	-	-	-	-	-	-	-	-	-
Cap Ex (Cap Ex plus acqs less disposals)	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Change To Working Capital	12	1	(0)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Increase in Net Other Liabilities	(0)	-	-	-	-	-	-	-	-	-	-	-
Free Cash Flow	30	18	18	18	19	19	20	20	21	21	21	22
Y/Y % Change	-	-0.7%	-0.9%	3.5%	2.5%	1.7%	2.4%	2.4%	2.4%	2.4%	1.9%	15x
Terminal Value	-	-	-	-	-	-	-	-	-	-	-	328
Discounted FCF	17	16	14	14	13	12	12	11	10	10	158	149
WACC	8.17%	8.17%	8.17%	8.17%	8.17%	8.17%	8.17%	8.17%	8.17%	8.17%	8.11%	15.8x ROIC=WACC
Simple Non-Growth Buffett DCF/Sh	\$18.35	\$11.17	\$11.09	\$10.99	\$11.37	\$11.65	\$11.85	\$12.13	\$12.42	\$12.72	\$13.03	158
Net Cash/Sh	2.63	2.63	2.63	2.63	2.63	2.63	2.63	2.63	2.63	2.63	2.63	278
Est Value/Sh (Futures Years Are Not-Discounted)	\$20.98	\$13.80	\$13.71	\$13.61	\$13.99	\$14.28	\$14.48	\$14.76	\$15.05	\$15.35	\$15.65	127
Free Cash Flow	30	18	18	18	19	19	20	20	21	21	21	22
Estimated Interest Payments	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Distributable Cash Flow	\$30.21	\$18.39	\$18.25	\$18.09	\$18.71	\$18.18	\$18.51	\$19.07	\$20.45	\$20.94	\$21.45	\$21.66
Estimated Dividends	\$13.63	\$13.63	\$13.63	\$13.63	\$13.63	\$13.63	\$13.63	\$13.63	\$13.63	\$13.63	\$13.63	\$13.63
Dividend Coverage	2.22x	1.35x	1.34x	1.33x	1.37x	1.41x	1.43x	1.47x	1.50x	1.54x	1.57x	1.57x
Funding Surplus (Gap)	\$17	\$5	\$5	\$4	\$5	\$6	\$6	\$6	\$7	\$7	\$8	\$8

CHECK OPERATING INCOME ASSUMPTIONS													Historical Ratios to Compare to Model Checks			
Pre-tax EBIT	28	28	30	30	31	32	32	33	34	34	35					
Y/Y Growth in EBIT	N/A	0.5%	4.4%	1.4%	2.5%	2.5%	1.8%	2.4%	2.4%	2.4%	2.4%					
Cumulative Geometric Growth Rate in EBIT	N/A	0.5%	2.4%	2.1%	2.2%	2.2%	2.1%	2.2%	2.2%	2.2%	2.2%					
Inferred Expected Growth in Operating Income (Using Marginal tax rate)	#VALUE!															
Inferred Expected Growth in Operating Income (Using Cash tax rate)	#VALUE!															
CHECK DEPRECIATION																
Sales	233	229	233	240	246	252	258	264	271	277	284	290				
Depreciation	1	1	1	1	1	1	1	1	1	1	1	1				
% of Sales	0.4%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%				
Dollar Change	0	0	0	0	0	0	0	0	0	0	0	0				
Pre-Tax Operating Income	28	28	30	30	31	32	32	33	34	34	35	36				
Dep as % of Operating Income	3.1%	4.0%	3.9%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%				
Cap Ex to Dep Ratio	0.05x	1.00x	1.00x	1.00x	1.00x	1.00x	1.00x	1.00x	1.00x	1.00x	1.00x	1.00x				
CHECK PP&E																
Net PP&E	1	1	1	1	1	1	1	1	1	1	1	1				
Plus: CapEx	0	1	1	1	1	1	1	1	1	1	1	1				
Less: Depreciation	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1				
Ending PP&E	1	1	1	1	1	1	1	1	1	1	1	1				
Depreciation As % of Sales	0.4%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%				
Dollar Change	0	0	0	0	0	0	0	0	0	0	0	0				
Depreciation % of Operating Income	3.1%	4.0%	3.9%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%				
Year-End Sales to Net PP&E	178.16x	174.66x	177.56x	183.21x	187.79x	192.48x	197.10x	201.83x	206.67x	211.64x	216.21x	221.00x				
CHECK AMORTIZATION																
Amortizable Base	0	0	0	0	0	0	0	0	0	0	0	0				
Annual Amortization	0	0	0	0	0	0	0	0	0	0	0	0				
Ending Balance	0	0	0	0	0	0	0	0	0	0	0	0				

Terminal Rate Assumptions

Method	Bottom Up	Hist Market	Min BU, 10Y P/E	ROIC=WACC
Terminal Multiple	15.8x	15.0x	15.8x	12.7x
Total Discounted FCF	286	278	286	255
Current Diluted Shares Outstanding	20	20	20	20
FCFF per share	\$14.19	\$13.77	\$14.19	\$12.66
Plus: Cash & Investments	\$2.61	\$2.61	\$2.61	\$2.61
Less: Equity Investments Per Share	\$0.00	\$0.00	\$0.00	\$0.00
Plus: Other Non-Cash Flow Generating Assets Per Share	\$0.00	\$0.00	\$0.00	\$0.00
Less: Debt Per Share	\$0.00	\$0.00	\$0.00	\$0.00
Less: Minority Interest Per Share	\$0.00	\$0.00	\$0.00	\$0.00
Less: Preferred Shares Per Share	\$0.00	\$0.00	\$0.00	\$0.00
Less: Underfunded Pension Obligations Per Share	\$0.00	\$0.00	\$0.00	\$0.00
Plus: Equity Options Per Share	\$0.01	\$0.01	\$0.01	\$0.01
Less: Expected Litigation Expense Per Share	\$0.00	\$0.00	\$0.00	\$0.00
Less: Expected Cash Restructuring Payments Per Share	\$0.00	\$0.00	\$0.00	\$0.00
Less: Off-Balance Sheet Debt Per Share	\$0.04	\$0.04	\$0.04	\$0.04
Less: Deferred Tax Liabilities Yet to Be Paid Per Share	\$0.00	\$0.00	\$0.00	\$0.00
FCFE Per Share	\$16.77	\$16.35	\$16.77	\$15.24
10-Yr Cumulative Probability of Default	0.4%	0.4%	0.4%	0.4%
Adjusted FCFE Per Share	\$16.70	\$16.29	\$16.70	\$15.18
CURRENT SHARE PRICE	\$15.11	\$15.11	\$15.11	\$15.11

Stage 1 & 2 (Non-Terminal Period) WACC

WACC From Bloomberg	9.94%
Bloomberg Cost of Equity	7.9%
Bloomberg Cost of Debt	0.0%
Bloomberg Cost of Preferred	0.0%
Bloomberg % Weight Equity	100.0%
Bloomberg % Weight Debt	0.0%
Bloomberg % Weight Preferred	0.0%
Bloomberg Equity (Country) Risk Premium	7.3%
Risk Free Rate	2.11%
Adjusted Beta	1.009
Our Equity Risk Premium	6.0%
Our Cost of Equity	8.2%
Our WACC	8.17%

Terminal Period (Year 11) Assumptions

WACC after 2018	8.1%
Constant growth rate of FCFF after 2018	1.80%
Imputed Multiple	15.8x
10-Yr Avg Multiple	16.7x
Minimum	15.8x

Terminal Period WACC

Diluted Share Market Cap	304.6
Book Value of Debt (SHOULD BE MARKET VALUE THOUGH)	0.0
Cost of Debt (SHOULD BE MARKET VALUE)	2.50%
10-Yr Risk Free Rate	2.11%
Equity Risk Premium	6.00%
Adjusted Beta (from Bloomberg)	1.009212732
Current Adj Beta	1.009212732
Cost of Equity	8.11%
Marginal Tax Rate	37%
Equity Weight	100.0%
Debt Weight	0.0%
Current WACC	8.17%
WACC (unlevered)	8.11%

Reinvestment rate required to equate ROIC to WACC in terminal period given terminal period growth assumption: 22.2%
5-Yr historical reinvestment rate -13.5%

Bottom Up Sensitivity Analysis

Terminal Discount Rate	Long Term Growth Rate						
	0.3%	0.8%	1.3%	1.8%	2.3%	2.8%	3.3%
6.6%	\$16.70	\$17.38	\$18.17	\$19.14	\$20.32	\$21.82	\$23.77
7.1%	\$16.13	\$16.70	\$17.38	\$18.17	\$19.14	\$20.32	\$21.82
7.6%	\$15.64	\$16.13	\$16.70	\$17.38	\$18.17	\$19.14	\$20.32
8.1%	\$15.21	\$15.64	\$16.13	\$16.70	\$17.38	\$18.17	\$19.14
8.6%	\$14.83	\$15.21	\$15.64	\$16.13	\$16.70	\$17.38	\$18.17
9.1%	\$14.49	\$14.83	\$15.21	\$15.64	\$16.13	\$16.70	\$17.38
9.6%	\$14.19	\$14.49	\$14.83	\$15.21	\$15.64	\$16.13	\$16.70

Est Terminal Period Multiple Embedded in Stock Price

Current Stock Price	\$15.11
Less: Non-Cash Flow Items	\$2.58
Adjusted Stock Price (ASP)	\$12.53
ASP* Diluted Shares Outstanding	\$252.68
Less: 1st 10 Year DCF	128.26
NPV Terminal Value	\$124
Terminal Multiple Assumed By Stock Price*	12.4x
*Based on our terminal value WACC and FCF estimate	