PETMED EXPRESS INC
Form 10-Q
January 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 December 31, 2017

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	(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: 20,601,106 Common Shares, $.001 par value per share at January 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)

	December 31, 2017 (Unaudited)	March 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 80,997	$ 58,730
Accounts receivable, less allowance for doubtful accounts of $26 and $27, respectively	1,715	1,808
Inventories - finished goods	21,907	20,228
Prepaid expenses and other current assets	974	1,019
Total current assets	105,593	81,785
Noncurrent assets:		
Property and equipment, net	29,138	30,164
Intangible assets	860	860
Total noncurrent assets	29,998	31,024
Total assets	$ 135,591	$ 112,809
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 12,426	$ 15,221
Income taxes payable	9,474	659
Accrued expenses and other current liabilities	3,034	2,475
Total current liabilities	24,934	18,355
Deferred tax liabilities	676	1,088
Total liabilities	25,610	19,443

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; 20,601 and 20,526 shares issued and outstanding, respectively	*21*	*21*
Additional paid-in capital	*8,664*	*6,806*
Retained earnings	*101,287*	*86,530*
Total shareholders' equity	*109,981*	*93,366*
Total liabilities and shareholders' equity	$ *135,591*	$ *112,809*

See accompanying notes to condensed consolidated financial statements.

1

PETMED EXPRESS, INC. AND SUBSIDIARIES

condensed consolidated statementS of COMPREHENSIVE INCOME

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	**2016**	**2017**	**2016**
Sales	$*60,110*	$*52,866*	$*206,478*	$*186,144*
Cost of sales	*38,166*	*36,223*	*133,590*	*128,985*
Gross profit	*21,944*	*16,643*	*72,888*	*57,159*
Operating expenses:				
General and administrative	*5,818*	*5,361*	*18,222*	*17,206*
Advertising	*4,126*	*3,170*	*14,944*	*13,312*
Depreciation	*532*	*457*	*1,590*	*855*
Total operating expenses	*10,476*	*8,988*	*34,756*	*31,373*
Income from operations	*11,468*	*7,655*	*38,132*	*25,786*
Other income:				
Interest income, net	*191*	*36*	*417*	*96*
Other, net	*265*	*130*	*755*	*206*
Total other income	*456*	*166*	*1,172*	*302*
Income before provision for income taxes	*11,924*	*7,821*	*39,304*	*26,088*
Provision for income taxes	*2,860*	*2,998*	*12,204*	*9,772*
Net income	$*9,064*	$*4,823*	$*27,100*	$*16,316*
Comprehensive income	$*9,064*	$*4,823*	$*27,100*	$*16,316*
Net income per common share:				
Basic	$*0.45*	$*0.24*	$*1.33*	$*0.81*
Diluted	$*0.44*	$*0.24*	$*1.33*	$*0.80*
Weighted average number of common shares outstanding:				
Basic	*20,368*	*20,253*	*20,337*	*20,223*
Diluted	*20,425*	*20,408*	*20,437*	*20,373*

Cash dividends declared per common share	$*0.20*	$*0.19*	$*0.60*	$*0.57*

See accompanying notes to condensed consolidated financial statements.

PETMED EXPRESS, INC. AND SUBSIDIARIES

condensed consolidated statementS of cash flows

(In thousands)(Unaudited)

	Nine Months Ended December 31, 2017			**2016**		
Cash flows from operating activities:						
Net income	$	*27,100*		$	*16,316*	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation		*1,590*			*855*	
Share based compensation		*1,858*			*1,444*	
Deferred income taxes		*(412*	)		*1,164*	
Bad debt expense		*72*			*368*	
(Increase) decrease in operating assets and increase (decrease) in liabilities:						
Accounts receivable		*21*			*(188*	)
Inventories - finished goods		*(1,679*	)		*10,661*	
Prepaid income taxes		-			*(632*	)
Prepaid expenses and other current assets		*45*			*857*	
Accounts payable		*(2,795*	)		*387*	
Income taxes payable		*8,815*			-	
Accrued expenses and other current liabilities		*530*			*410*	
Net cash provided by operating activities		*35,145*			*31,642*	
Cash flows from investing activities:						
Purchases of property and equipment		*(564*	)		*(9,860*	)

Net cash used in investing activities		(564	)		(9,860	)
Cash flows from financing activities:						
Dividends paid		(12,314	)		(11,632	)
Excess tax benefits related to restricted stock		-			115	
Net cash used in financing activities		(12,314	)		(11,517	)
Net increase in cash and cash equivalents		22,267			10,265	
Cash and cash equivalents, at beginning of period		58,730			37,639	
Cash and cash equivalents, at end of period	$	80,997		$	47,904	
Supplemental disclosure of cash flow information:						
Cash paid for income taxes	$	3,801		$	9,246	
Prepaid property and equipment in current assets	$	-		$	863	
Dividends payable in accrued expenses	$	246		$	196	

See accompanying notes to condensed consolidated financial statements.

3

PETMED EXPRESS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note *1:* Summary of Significant Accounting Policies

Organization

PetMed Express, Inc. and subsidiaries, 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 *2018* or Fiscal *2017* refer to the Company's fiscal years ending *March 31, 2018* and *2017,* 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 *December 31, 2017,* the Statements of Comprehensive Income for the *three* and *nine* months ended *December 31, 2017* and *2016,* and Cash Flows for the *nine* months ended *December 31, 2017* and *2016.* The results of operations for the *three* and *nine* months ended *December 31, 2017* are *not* necessarily indicative of the operating results expected for the fiscal year ending *March 31, 2018.* 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, 2017.* 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." This ASU clarifies the accounting for revenue arising from contracts with customers and specifies the disclosures that an entity should include in its financial statements. The standard was effective for annual reporting periods beginning after *December 15, 2017.* 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 effective date and transition requirements for these amendments are the same as those of the original ASU. The guidance permits *two* methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method).

The Company currently anticipates adopting the standard using the modified retrospective method. The Company has performed a high level analysis of its revenue streams and expects to complete its evaluations in FY *2018,* as well as an evaluation of the impact on its business processes, controls and systems. The Company does *not* expect this standard to affect the Company materially, other than increased disclosures. We plan to complete our assessment of the impact of adoption during fiscal *2018* and finalize the adoption of the new revenue standard in fiscal *2019.*

In *March 2016,* the FASB released Accounting Standards Update on Stock Compensation Improvements to Employee Share-Based Payment Accounting (Topic *718*) (ASU *2016-09*). ASU *2016-09* requires entities to recognize the income tax effects of share-based awards in the income statement when the awards vest or are settled. The objective of this update is to simplify several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new standard was effective for annual and interim periods beginning *January 1, 2017.* We early adopted this standard as of *March 31, 2017.* The Company expects that this accounting pronouncement *may* have a material effect on the Company's effective tax rate in fiscal *2018,* based on the Company's stock price.

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:* 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	Nine Months Ended
	December 31,	December 31,

	2017	2016	2017	2016
Net income (numerator):				
Net income	$*9,064*	$*4,823*	$*27,100*	$*16,316*
Shares (denominator):				
Weighted average number of common shares outstanding used in basic computation	*20,368*	*20,253*	*20,337*	*20,223*
Common shares issuable upon vesting of restricted stock	*47*	*145*	*90*	*140*
Common shares issuable upon conversion of preferred shares	*10*	*10*	*10*	*10*
Shares used in diluted computation	*20,425*	*20,408*	*20,437*	*20,373*
Net income per common share:				
Basic	$*0.45*	$*0.24*	$*1.33*	$*0.81*
Diluted	$*0.44*	$*0.24*	$*1.33*	$*0.80*

For the *three* and *nine* months ended *December 31, 2017, 77,600* 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 *nine* months ended *December 31, 2016,* all common restricted stock was included in the diluted net income per common share computation.

Note *3:* Accounting for 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 *974,860* restricted common shares issued under the *2006* Employee Equity Compensation Restricted Stock Plan (*"2006* Employee Plan"), *47,600* 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 *60,000* 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 *December 31, 2017,* 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.

For the quarters ended *December 31*, *2017* and *2016,* the Company recognized *$712,000* and *$498,000,* respectively, of compensation expense related to the Employee and Director Plans. For the *nine* months ended *December 31, 2017* and *2016,* the Company recognized *$1.9* million and *$1.4* million, respectively, of compensation expense related to the Employee and Director Plans. At *December 31, 2017* and *2016,* there was *$5.1* million and *$3.8* 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 *December 31, 2017* and *2016,* there were approximately *233,000* and *273,000* non-vested restricted shares, respectively.

Note *4:* 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 *December 31, 2017,* the Company had invested the majority of its *$81.0* million cash and cash equivalents balance in money market funds which are classified within level *1.*

Note *5*: Commitments and Contingencies

In *June 2017,* the Company was served with a lawsuit by a veterinary clinic, styled Animal Medical Center of Orland Park, Inc. v. PetMed Express, Inc., d/b/a *1-800*-PetMeds, and John Does *1-10,* Circuit Court of Cook County, Illinois, Chancery Division, *2017*-CH-*07347.* The plaintiff alleged that the Company was sending unsolicited advertisements via facsimile in violation of the Telephone Consumer Protection Act, and also seeks class action status. On *November 13, 2017,* this matter was voluntarily dismissed by the plaintiffs, with prejudice.

On *August 25, 2017* and *September 7, 2017,* shareholders filed putative securities class action lawsuits in the United States District Court for the Southern District of Florida, which were subsequently consolidated, against PetMed Express, Inc. (the “Company”) and the Company’s principal executive officers, *one* of whom is also a director. Relying exclusively on a false and defamatory, anonymous “report” posted on *August 23, 2017* on the Aurelius Value website the plaintiffs alleged violations of Sections *10*(b) and *20*(a) of the Securities Exchange Act of *1934.* The Company has always denied and continues to deny the plaintiffs’ unfounded accusations. The plaintiffs investigated their claims, and on or about *January 19, 2018,* the plaintiffs voluntarily dismissed the consolidated lawsuit without prejudice.

6

The Company has settled complaints that had been filed with various states' regulatory 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 *6*: Changes in Shareholders' Equity and Comprehensive Income:

Changes in shareholders' equity for the *nine* months ended *December 31, 2017* are summarized below (in thousands):

	Additional Paid-In Capital	**Retained Earnings**
Beginning balance at March 31, 2017:	$ *6,806*	$ *86,530*
Share based compensation	*1,858*	-
Dividends declared	-	*(12,343*)
Net income	-	*27,100*
Ending balance at December 31, 2017:	$ *8,664*	$ *101,287*

No shares of treasury stock were purchased or retired in the *nine* months ended *December 31, 2017* and *2016.*

Note *7*: Income Taxes

For the quarters ended *December 31, 2017* and *2016,* the Company recorded an income tax provision of approximately *$2.9* million and *$3.0* million, respectively, and for the *nine* months ended *December 31, 2017* and *2016,* the Company recorded an income tax provision of approximately *$12.2* million and *$9.8* million, respectively. The decrease to the income tax provision for the *three* months ended *December 31, 2017,* is related to an income tax rate reduction pursuant to the Tax Cuts and Jobs Act of *2017* ("*2017* Act"), offset by an increase in operating income. The increase to the income tax provision for the *nine* months ended *December 31, 2017,* is related to an increase in operating income offset by the income tax rate reduction due to the *2017* Act. The effective tax rate for the quarter ended *December 31, 2017* was approximately *24.0%,* compared to *38.3%* for the quarter ended *December 31, 2016,* and the effective tax rate for the *nine* months ended *December 31, 2017* was approximately *31.1%,* compared to *37.5%* for the *nine* months ended *December 31, 2016.* The decrease to the effective rate for the *three* and *nine* months ended *December 31, 2017* is due to a reduction in the Company's corporate tax rate pursuant to the *2017* Act. In accordance with SEC Staff Bulletin *No. 118,* fiscal year end companies were required to determine the appropriate blended rate to apply based on their respective fiscal year end date. Therefore, instead of applying a *35.0%* federal tax rate for the quarter and *nine* months ended *December 31, 2017,* the Company applied a blended federal rate of *31.5%.* This blended rate was applied to the *nine* months ended *December 31, 2017,* resulting in a tax benefit of approximately *$1.7* million, which also included a *one*-time *$384,000* reduction to our deferred tax liabilities due to the federal tax rate reduction. The Company also recognized a *one*-time charge of *$175,000* related to a true up of the fiscal *2017* income tax provision, which was recognized in the quarter ended *December 31, 2017.*

Note *8*: Subsequent Events

On or about *January 19, 2018,* the plaintiffs voluntarily dismissed the consolidated putative securities class action lawsuit, filed in *August* and *September 2017,* without prejudice.

On *January 22, 2018* our Board of Directors declared an increased quarterly dividend of *$0.25* per share. The Board established a *February 5, 2018* record date and a *February 16, 2018* payment date. Based on the outstanding share balance as of *January 30, 2018* the Company estimates the dividend payable to be approximately *$5.2* 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 84% of all sales were generated via the Internet for the quarter ended December 31, 2017, compared to 83% for the quarter ended December 31, 2016. The Company's sales consist of products sold mainly to retail consumers. The three-month average purchase was approximately $86 and $81 per order for the quarters ended December 31, 2017 and 2016, respectively, and for the nine months ended December 31, 2017 and 2016, the average purchase was approximately $86 and $82 per order, 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 medications and pet supplies primarily to retail consumers. The Company's policy is to recognize revenue from product sales upon shipment, when the rights of ownership and risk of loss have passed to the customer. Outbound shipping and handling fees are included in sales 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 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 $26,000 at December 31, 2017 compared to $27,000 at March 31, 2017.

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 $55,000 at December 31, 2017 compared to $51,000 at March 31, 2017.

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 December 31,		**Nine Months Ended December 31,**	
	2017	**2016**	**2017**	**2016**
Sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales	63.5	68.5	64.7	69.3
Gross profit	36.5	31.5	35.3	30.7
Operating expenses:				
General and administrative	9.7	10.1	8.8	9.2
Advertising	6.8	6.0	7.2	7.2
Depreciation	0.9	0.9	0.8	0.5
Total operating expenses	17.4	17.0	16.8	16.9
Income from operations	19.1	14.5	18.5	13.8
Total other income	0.8	0.3	0.5	0.2
Income before provision for income taxes	19.9	14.8	19.0	14.0
Provision for income taxes	4.8	5.7	5.9	5.2
Net income	15.1 %	9.1 %	13.1 %	8.8 %

9

Three Months Ended December 31, 2017 Compared With Three Months Ended December 31, 2016, and Nine Months Ended December 31, 2017 Compared With Nine Months Ended December 31, 2016

Sales

Sales increased by approximately $7.2 million, or 13.7%, to approximately $60.1 million for the quarter ended December 31, 2017, from approximately $52.9 million for the quarter ended December 31, 2016. For the nine months ended December 31, 2017, sales increased by approximately $20.3 million, or 10.9%, to approximately $206.5 million compared to $186.1 million for the nine months ended December 31, 2016. The increases in sales for the three and nine months ended December 31, 2017 were primarily due to increased new order and reorder sales. The Company acquired approximately 106,000 new customers for the quarter ended December 31, 2017, compared to approximately 99,000 new customers for the same period the prior year. For the nine months ended December 31, 2017 the Company acquired approximately 408,000 new customers, compared to 388,000 new customers for the nine months ended December 31, 2016. The following chart illustrates sales by various sales classifications:

Three Months Ended December 31,						
Sales (In thousands)	**2017**	**%**	**2016**	**%**	**$ Variance**	**% Variance**
Reorder Sales	$50,949	84.8 %	$44,937	85.0 %	$ 6,012	13.4 %
New Order Sales	$9,161	15.2 %	$7,929	15.0 %	$ 1,232	15.5 %
Total Net Sales	$60,110	100.0%	$52,866	100.0%	$ 7,244	13.7 %
Internet Sales	$50,358	83.8 %	$43,772	82.8 %	$ 6,586	15.0 %