
**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 June 30, 2019

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: **001-38163**

PetIQ, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

35-2554312

(I.R.S. Employer Identification No.)

923 S. Bridgeway Pl.

Eagle, Idaho

(Address of principal executive offices)

83616

(Zip Code)

208-939-8900

(Registrant's telephone number, including area code)

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

Securities registered pursuant to Section 12(g) of the Act: None

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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 the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Emerging growth company

Accelerated filer

Smaller reporting 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 (as defined in Rule 12b-2 of the Exchange Act). Yes No

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol	Name of Each Exchange on Which Registered
Class A Common Stock, \$0.001 par value	PETQ	The Nasdaq Global Select Market

As of August 8, 2019, we had 22,976,976 shares of Class A common stock and 5,246,252 shares of Class B common stock outstanding.

PetIQ, Inc.

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PetIQ, Inc.
Condensed Consolidated Balance Sheets
(Unaudited, in 000's except for per share amounts)

	June 30, 2019	December 31, 2018
Current assets		
Cash and cash equivalents	\$ 36,564	\$ 66,360
Accounts receivable, net	85,129	45,007
Inventories	98,433	92,142
Other current assets	2,874	4,212
Total current assets	223,000	207,721
Property, plant and equipment, net	26,303	27,335
Operating lease right of use assets	11,990	—
Deferred tax assets	48,620	43,946
Other non-current assets	2,896	2,857
Intangible assets, net	85,995	88,546
Goodwill	125,040	125,029
Total assets	\$ 523,844	\$ 495,434
Liabilities and equity		
Current liabilities		
Accounts payable	\$ 61,234	\$ 54,768
Accrued wages payable	6,725	5,295
Accrued interest payable	547	728
Other accrued expenses	877	1,154
Current portion of operating leases	3,306	—
Current portion of long-term debt and finance leases	2,338	2,251
Total current liabilities	75,027	64,196
Operating leases, less current installments	8,895	—
Long-term debt, less current installments	99,723	107,418
Finance leases, less current installments	1,768	2,319
Other non-current liabilities	254	524
Total non-current liabilities	110,640	110,261
Commitments and contingencies		
Equity		
Additional paid-in capital	282,343	262,219
Class A common stock, par value \$0.001 per share, 125,000 shares authorized; 22,750 and 21,620 shares issued and outstanding, respectively	22	22
Class B common stock, par value \$0.001 per share, 100,000 shares authorized; 5,462 and 6,547 shares issued and outstanding, respectively	7	7
Retained Earnings (Accumulated deficit)	976	(4,450)
Accumulated other comprehensive loss	(1,327)	(1,316)
Total stockholders' equity	282,020	256,481
Non-controlling interest	56,157	64,496
Total equity	338,177	320,977
Total liabilities and equity	\$ 523,844	\$ 495,434

See accompanying notes to the condensed consolidated financial statements.

PetIQ, Inc.
Condensed Consolidated Statements of Income
(Unaudited, in 000's except for per share amounts)

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Product sales	\$ 194,606	\$ 148,713	\$ 320,690	\$ 246,564
Services revenue	26,028	22,429	48,380	39,644
Total net sales	220,634	171,142	369,070	286,208
Cost of products sold	167,845	127,583	275,909	212,169
Cost of services	17,889	17,241	33,531	31,838
Total cost of sales	185,734	144,824	309,440	244,007
Gross profit	34,900	26,318	59,630	42,201
Operating expenses				
General and administrative expenses	24,450	16,943	44,988	35,911
Contingent note revaluations loss	1,460	459	780	600
Operating income	8,990	8,916	13,862	5,690
Interest expense, net	(2,242)	(2,216)	(4,179)	(3,981)
Foreign currency gain (loss), net	49	136	(73)	58
Other income (expense), net	2	(418)	15	(373)
Total other expense, net	(2,191)	(2,498)	(4,237)	(4,296)
Pretax net income	6,799	6,418	9,625	1,394
Income tax (expense) benefit	(881)	(1,020)	(1,381)	47
Net income	5,918	5,398	8,244	1,441
Net income attributable to non-controlling interest	2,103	2,899	2,818	970
Net income attributable to PetIQ, Inc.	\$ 3,815	\$ 2,499	\$ 5,426	\$ 471
Net income per share attributable to PetIQ, Inc. Class A common stock				
Basic	\$ 0.17	\$ 0.16	\$ 0.25	\$ 0.03
Diluted	\$ 0.17	\$ 0.16	\$ 0.24	\$ 0.03
Weighted Average shares of Class A common stock outstanding				
Basic	22,365	15,980	22,087	15,285
Diluted	22,597	16,008	22,284	15,329

See accompanying notes to the condensed consolidated financial statements.

PetIQ, Inc.
Condensed Consolidated Statements of Comprehensive Income
(Unaudited, in 000's)

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Net income	\$ 5,918	\$ 5,398	\$ 8,244	\$ 1,441
Foreign currency translation adjustment	(526)	(725)	(27)	(289)
Comprehensive income	5,392	4,673	8,217	1,152
Comprehensive income attributable to non-controlling interest	1,998	2,668	2,806	901
Comprehensive income attributable to PetIQ	\$ 3,394	\$ 2,005	\$ 5,411	\$ 251

See accompanying notes to the condensed consolidated financial statements.

PetIQ, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited, in 000's)

	For the Six Months Ended June 30,	
	2019	2018
Cash flows from operating activities		
Net income	\$ 8,244	\$ 1,441
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation and amortization of intangible assets and loan fees	6,056	5,714
Foreign exchange gain on liabilities	—	(41)
Gain on disposition of property, plant, and equipment	(62)	(49)
Stock based compensation expense	3,146	1,454
Deferred tax adjustment	1,638	(47)
Contingent note revaluations	780	600
Other non-cash activity	56	(334)
Changes in assets and liabilities		
Accounts receivable	(40,218)	(20,820)
Inventories	(6,294)	(29,384)
Other assets	1,250	2,654
Accounts payable	6,656	31,859
Accrued wages payable	1,407	410
Other accrued expenses	(717)	(2,304)
Net cash used in operating activities	(18,058)	(8,847)
Cash flows from investing activities		
Proceeds from disposition of property, plant, and equipment	69	103
Purchase of property, plant, and equipment	(1,730)	(4,732)
Business acquisitions (net of cash acquired)	—	(92,083)
Net cash used in investing activities	(1,661)	(96,712)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	323,144	299,078
Principal payments on long-term debt	(331,856)	(215,964)
Tax Distributions to LLC Owners	(1,378)	(574)
Principal payments on finance lease obligations	(737)	(561)
Payment of deferred financing fees and debt discount	(50)	(2,613)
Exercise of options to purchase common stock	798	—
Net cash (used in) provided by financing activities	(10,079)	79,366
Net change in cash and cash equivalents	(29,798)	(26,193)
Effect of exchange rate changes on cash and cash equivalents	2	(31)
Cash and cash equivalents, beginning of period	66,360	37,896
Cash and cash equivalents, end of period	\$ 36,564	\$ 11,672

See accompanying notes to the condensed consolidated financial statements.

PetIQ, Inc.
Condensed Consolidated Statements of Cash Flows, Continued
(Unaudited, in 000's)

Supplemental cash flow information	For the Six Months Ended June 30,	
	2019	2018
Interest paid	\$ 4,454	\$ 3,104
Property, plant, and equipment acquired through accounts payable	(164)	(433)
Finance lease additions	315	34
Net change of deferred tax asset from step-up in basis	6,093	12,505
Income taxes paid	197	400
Accrued tax distribution	1,054	693
Non cash consideration - Contingent notes	—	6,900
Non cash consideration - Guarantee note	—	10,000
Non cash consideration - Issuance of Class B common stock and LLC Interests	—	90,031

PetIQ, Inc.
Condensed Consolidated Statements of Equity
(Unaudited, in 000's)

	Three months ended June 30, 2019								
	Retained Earnings/ (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Class A Common		Class B Common		Additional Paid-in Capital	Non-controlling Interest	Total Equity
			Shares	Dollars	Shares	Dollars			
Balance - March 31, 2019	\$ (2,839)	\$ (941)	22,157	\$ 22	6,028	\$ 6	\$ 271,916	\$ 60,418	\$ 328,582
Exchange of LLC Interests held by LLC Owners	—	35	566	—	(566)	1	5,759	(5,794)	—
Net increase in deferred tax asset from LLC Interest transactions	—	—	—	—	—	—	2,955	—	2,955
Accrued tax distributions	—	—	—	—	—	—	—	(797)	(797)
Other comprehensive loss	—	(421)	—	—	—	—	—	(105)	(526)
Stock based compensation expense	—	—	—	—	—	—	1,230	332	1,562
Exercise of Options to purchase Common Stock	—	—	22	—	—	—	483	—	483
Issuance of stock for vesting of RSU's	—	—	5	—	—	—	—	—	—
Net Income	3,815	—	—	—	—	—	—	2,103	5,918
Balance - June 30, 2019	\$ 976	\$ (1,327)	22,750	\$ 22	5,462	\$ 7	\$ 282,343	\$ 56,157	\$ 338,177

	Six months ended June 30, 2019								
	Retained Earnings/ (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Class A Common		Class B Common		Additional Paid-in Capital	Non-controlling Interest	Total Equity
			Shares	Dollars	Shares	Dollars			
Balance - December 31, 2018	\$ (4,450)	\$ (1,316)	21,620	\$ 22	6,547	\$ 7	\$ 262,219	\$ 64,496	\$ 320,977
Exchange of LLC Interests held by LLC Owners	—	4	1,085	—	(1,085)	—	10,808	(10,812)	—
Net increase in deferred tax asset from LLC Interest transactions	—	—	—	—	—	—	6,093	—	6,093
Accrued tax distributions	—	—	—	—	—	—	—	(1,054)	(1,054)
Other comprehensive loss	—	(15)	—	—	—	—	—	(12)	(27)
Stock based compensation expense	—	—	—	—	—	—	2,425	721	3,146
Exercise of Options to purchase Common Stock	—	—	38	—	—	—	798	—	798
Issuance of stock for vesting of RSU's	—	—	7	—	—	—	—	—	—
Net Income	5,426	—	—	—	—	—	—	2,818	8,244
Balance - June 30, 2019	\$ 976	\$ (1,327)	22,750	\$ 22	5,462	\$ 7	\$ 282,343	\$ 56,157	\$ 338,177

Note that certain figures shown in the tables above may not recalculate due to rounding.

See accompanying notes to the condensed consolidated financial statements.

PetIQ, Inc.
Condensed Consolidated Statements of Equity (continued)
(Unaudited, in 000's)

	Three months ended June 30, 2018								
	Accumulated Deficit	Accumulated Other Comprehensive Loss	Class A Common		Class B Common		Additional Paid-in Capital	Non-controlling Interest	Total Equity
			Shares	Dollars	Shares	Dollars			
	\$	\$	16,132	\$ 16	8,402	\$ 8	\$ 137,916	\$ 68,497	\$ 200,314
Balance - March 31, 2018	(5,696)	(427)							
ASC 606 adoption, net of tax	—	—	—	—	—	—	—	—	—
Issuance of equity for business combination	—	—	—	—	1,157	1	(1)	—	—
Exchange of LLC Interests held by Continuing LLC Owners	—	8	516	—	(516)	—	4,132	(4,140)	—
Net increase in deferred tax asset from LLC Interest transactions	—	—	—	—	—	—	3,524	—	3,524
Accrued tax distributions	—	—	—	—	—	—	—	(259)	(259)
Other comprehensive loss	—	(494)	—	—	—	—	—	(231)	(725)
Stock based compensation expense	—	—	—	—	—	—	483	273	756
Net income	2,499	—	—	—	—	—	—	2,899	5,398
Balance - June 30, 2018	\$ (3,197)	\$ (913)	16,648	\$ 16	9,043	\$ 9	\$ 146,054	\$ 67,039	\$ 209,008

	Six months ended June 30, 2018								
	Accumulated Deficit	Accumulated Other Comprehensive Loss	Class A Common		Class B Common		Additional Paid-in Capital	Non-controlling Interest	Total Equity
			Shares	Dollars	Shares	Dollars			
	\$	\$	13,223	\$ 13	8,268	\$ 8	\$ 70,873	\$ 38,130	\$ 104,844
Balance - December 31, 2017	(3,493)	(687)							
ASC 606 adoption, net of tax	(175)	—	—	—	—	—	—	(110)	(285)
Issuance of equity for business combination	—	112	—	—	4,200	4	36,280	53,635	90,031
Exchange of LLC Interests held by LLC Owners	—	(118)	3,425	3	(3,425)	(3)	25,517	(25,399)	—
Net increase in deferred tax asset from LLC Interest transactions	—	—	—	—	—	—	12,505	—	12,505
Accrued tax distributions	—	—	—	—	—	—	—	(693)	(693)
Other comprehensive loss	—	(220)	—	—	—	—	—	(69)	(289)
Stock based compensation expense	—	—	—	—	—	—	879	575	1,454
Net income	471	—	—	—	—	—	—	970	1,441
Balance - June 30, 2018	\$ (3,197)	\$ (913)	16,648	\$ 16	9,043	\$ 9	\$ 146,054	\$ 67,039	\$ 209,008

Note that certain figures shown in the tables above may not recalculate due to rounding.

See accompanying notes to the condensed consolidated financial statements.

PetIQ Inc.
Notes to the Condensed Consolidated Financial Statements (unaudited)

Note 1 – Principal Business Activity and Significant Accounting Policies

Principal Business Activity and Principles of Consolidation

PetIQ is a leading, rapidly growing pet health and wellness company. Through points of distribution across retail and e-commerce channels, PetIQ has a mission to make pet lives better by educating pet parents on the importance of offering regular, convenient access and affordable choices for pet preventative and wellness veterinary products and services. PetIQ believes that pets are an important part of the family and deserve the best products and care we can give them.

We are the managing member of PetIQ Holdings, LLC (“Holdco”), a Delaware limited liability company, which is the sole member of PetIQ, LLC (“Opco”) and, through Holdco, operate and control all the business and affairs of Opco.

The condensed consolidated financial statements as of June 30, 2019 and December 31, 2018 and for the three and six months ended June 30, 2019 and 2018 are unaudited. The condensed consolidated balance sheet as of December 31, 2018 has been derived from the audited financial statements at that date but does not include all of the disclosures required by U.S. GAAP. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements as of and for the year ended December 31, 2018 and related notes thereto included in most recent annual report and filed with the Securities and Exchange Commission (“SEC”) on Form 10-K on March 12, 2019. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the full year.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP 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 consolidated financial statements and the reported amounts of sales and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of property, plant, and equipment and intangible assets; the valuation of property, plant, and equipment, intangible assets and goodwill, the valuation of assets and liabilities in connection with acquisitions, the valuation of deferred tax assets, the valuation of inventories, and reserves for legal contingencies.

Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. The accounting guidance establishes a three-tiered hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The categorization of a financial instrument within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The carrying amounts of the Company’s financial instruments, including cash, accounts receivable, accounts payable and accrued liabilities, are at cost, which approximates fair value due to their relatively short maturities. The guarantee

notes are carried at cost, which approximates fair value as the stated interest rate is consistent with current market rates. Our term loan and revolving credit facility bear interest at a variable interest rate plus an applicable margin and, therefore, carrying amounts approximate fair value.

The following table presents liabilities measured at fair value on a recurring basis:

<i>\$'s in 000's</i>	<u>June 30, 2019</u>		<u>December 31, 2018</u>	
Liabilities:				
2019 Contingent note	\$	3,460	\$	2,680

In connection with the acquisition of Community Veterinary Clinics, LLC d/b/a VIP Petcare (“VIP” and such acquisition, the “VIP Acquisition”) a portion of the purchase price was structured in the form of Contingent Notes (the “Contingent Notes”) that vest based on the combined Company EBITDA targets for the years ending December 31, 2018 and 2019 (“Measurement Dates”). See Note 2 – “Business Combinations” for more information regarding the VIP Acquisition. The Company is required to reassess the fair value of the Contingent Notes at each reporting period. As of December 31, 2018, \$7.5 million was payable pursuant to the 2018 Contingent Note, subject to the same payment terms described below. As such, the portion of the liability as it relates to the 2018 Contingent Note became fixed as of December 31, 2018.

For the 2019 Contingent Note, a Monte Carlo simulation method was utilized in estimating the fair value (Level 3) of the Contingent Note. The simulation model is a numerical algorithm that generates thousands of scenarios for the future EBITDA in order to assess the probability of achieving the EBITDA hurdles. The valuation model simulates the last twelve months EBITDA from the Valuation Date to the end of each Measurement Date in one ‘jump’. The Contingent Notes were valued within a risk-neutral option pricing framework with the real growth rate adjusted for the market price of EBITDA risk. The Company used the WACC less risk-free rate as a proxy for the EBITDA risk premium.

Although the Company believes its estimates and assumptions are reasonable, different assumptions, including those regarding the operating results of the Company, or changes in the future may result in different estimated amounts.

The contingent consideration is included in long-term debt in the accompanying condensed consolidated balance sheets. The Company will satisfy this obligation with a cash payment to the sellers due in July 2023 upon the achievement of the respective milestones discussed above. The Contingent Notes will bear interest at a fixed rate of 6.75%, beginning upon the achievement of the respective milestones discussed above.

The following table summarizes the Level 3 activity related to the Contingent Notes:

<i>\$'s in 000's</i>	Six months ended	
	June 30, 2019	June 30, 2018
Balance at beginning of the period	\$ 2,680	\$ —
Fair value of contingent consideration at VIP Acquisition date	—	6,900
Change in fair value of contingent consideration	780	600
Balance at the end of the period	<u>\$ 3,460</u>	<u>\$ 7,500</u>

Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments with an original maturity of three months or less at the date of acquisition. All credit card, debit card and electronic transfer transactions that process in less than seven days are classified as cash and cash equivalents. The Company maintains its cash accounts in various deposit accounts, the balances of which at times exceeded federal deposit insurance limits during the periods presented.

Receivables and Credit Policy

Trade receivables due from customers are uncollateralized customer obligations due under normal trade terms generally requiring payment within 45 days from the invoice date. Accounts receivable are stated at the amount billed to the customer, net of discounts and estimated deductions. The Company does not have a policy for charging interest on overdue customer account balances. The Company provides an allowance for doubtful accounts equal to estimated uncollectible amounts. The Company's estimate is based on historical collection experience and a review of the current status of trade accounts receivable. Payments of trade receivables are allocated to the specific invoices identified on the customer's remittance advice.

Other receivables consists of various receivables due from vendors, banking partners, and notes receivable from suppliers. Non-current portions of these other receivables are included in other non-current assets on the consolidated balance sheets.

Accounts receivable consists of the following as of:

<i>\$'s in 000's</i>	June 30, 2019	December 31, 2018
Trade receivables	\$ 79,283	\$ 43,531
Other receivables	6,237	1,764
	<u>85,520</u>	<u>45,295</u>
Less: Allowance for doubtful accounts	(378)	(216)
Non-current portion of receivables	(13)	(72)
Total accounts receivable, net	<u>\$ 85,129</u>	<u>\$ 45,007</u>

Inventories

Inventories are stated at the lower of cost or net realizable value, which approximate the first-in first-out ("FIFO") method and includes estimated rebate amounts. The Company maintains reserves for estimated obsolete or unmarketable inventory based on the difference between the cost of inventory and its estimated net realizable value. In estimating the reserves, management considers factors such as excess or slow-moving inventories, product expiration dating, and

market conditions. Changes in these conditions may result in additional reserves. Major components of inventories consist of the following as of:

<i>\$'s in 000's</i>	June 30, 2019	December 31, 2018
Raw materials	\$ 6,580	\$ 6,106
Work in progress	89	94
Finished goods	91,764	85,942
Total inventories	<u>\$ 98,433</u>	<u>\$ 92,142</u>

Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost. Expenditures for improvements that significantly add to the productive capacity or extend the useful life of an asset are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred.

Depreciation and amortization is provided using the straight-line method, based on useful lives of the assets, except for leasehold improvements and finance leased assets which are depreciated over the shorter of the expected useful life or the lease term. Depreciation and amortization expense is recorded in cost of sales and general and administrative expenses in the condensed consolidated statements of operations, depending on the use of the asset. The estimated useful lives of property, plant, and equipment are as follows:

Computer equipment and software	3 years
Vehicle and vehicle accessories	3-5 years
Buildings	33 years
Equipment	2-15 years
Leasehold improvements	3-15 years
Furniture and fixtures	5-10 years

Revenue Recognition

When Performance Obligations Are Satisfied

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account for revenue recognition. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The Company's performance obligations are product sales and the delivery of veterinary services.

Revenue is generally recognized for product sales on a point in time basis when product control is transferred to the customer. In general, control transfers to the customer when the product is shipped or delivered to the customer based upon applicable shipping terms, as the customer can direct the use and obtain substantially all of the remaining benefits from the asset at this point in time.

The Company determined that certain products manufactured to a customer's specifications do not have an alternative future use at a reasonable profit margin due to costs associated with reworking, transporting and repackaging these products. These products are produced subject to purchase orders that include an enforceable right to payment. Therefore the Company determined that revenue on these products would be recognized over time, as the products are produced. This represents a minor subset of the products the Company manufactures.

Revenue is recognized for services over time when the service is delivered.

Customer contracts generally do not include more than one performance obligation. When a contract does contain more than one performance obligation, we allocate the contract's transaction price to each performance obligation based on its relative standalone selling price. The standalone selling price for each distinct good is generally determined by directly observable data.

The performance obligations in our contracts are satisfied within one year. As such, we have not disclosed the transaction price allocated to remaining performance obligations as of June 30, 2019.

Significant Payment Terms

Our customer contracts identify the product, quantity, price, payment and final delivery terms. Payment terms usually include early pay discounts. We grant payment terms consistent with industry standards. Although some payment terms may be more extended, no terms beyond one year are granted at contract inception. As a result, we do not adjust the promised amount of consideration for the effects of a significant financing component because the period between our transfer of a promised good or service to a customer and the customer's payment for that good or service will be one year or less.

Shipping

All shipping and handling costs associated with outbound freight are accounted for as fulfillment costs and are included in the cost of sales. This includes shipping and handling costs after control over a product has transferred to a customer.

Variable Consideration

In addition to fixed contract consideration, most contracts include some form of variable consideration. The most common forms of variable consideration include discounts, rebates, and sales returns and allowances. Variable consideration is treated as a reduction in revenue when product revenue is recognized. Depending on the specific type of variable consideration, we use either the expected value or most likely amount method to determine the variable consideration. We believe there will not be significant changes to our estimates of variable consideration when any related uncertainties are resolved with our customers. The Company reviews and updates its estimates and related accruals of variable consideration each period based on the terms of the agreements, historical experience, and any recent changes in the market. Any uncertainties in the ultimate resolution of variable consideration due to factors outside of the Company's influence are typically resolved within a short timeframe therefore not requiring any additional constraint on the variable consideration.

Trade marketing expense, consisting primarily of customer pricing allowances and merchandising funds are offered through various programs to customers and are designed to promote our products. They include the cost of in-store product displays, feature pricing in retailers' advertisements and other temporary price reductions. These programs are offered to our customers both in fixed and variable (rate per case) amounts. The ultimate cost of these programs depends on retailer performance and is subject to management estimates.

Certain retailers require the payment of product introductory fees in order to obtain space for the Company's products on the retailer's store shelves. This cost is typically a lump sum and is determined using the expected value based on the contract between the two parties.

Both trade marketing expense and product introductory fees are recognized as reductions of revenue at the time the transfer of control of the associated products occurs. Accruals for expected payouts, or amounts paid in advance, under these programs are included as other current assets or accounts payable in the Condensed Consolidated Balance Sheets.

Warranties & Returns

PetIQ provides all customers with a standard or assurance type warranty. Either stated or implied, the Company provides assurance the related products will comply with all agreed-upon specifications and other warranties provided under the law. No significant services beyond an assurance warranty are provided to customers.

The Company does not grant a general right of return. However, customers may return defective or non-conforming products. Customer remedies may include either a cash refund or an exchange of the product. As a result, the right of

return and related refund liability is estimated and recorded as a reduction in revenue. This return estimate is reviewed and updated each period and is based on historical sales and return experience.

Contract balances

Contract asset and liability balances as of June 30, 2019 and December 31, 2018 are immaterial. The Company does not have significant deferred revenue or unbilled receivable balances.

Cost of Services

Cost of Services are comprised of all service and product costs related to the delivery of veterinary services, including but not limited to, salaries of veterinarians, technicians and other clinic based personnel, transportation and delivery costs, rent, occupancy costs, supply costs, depreciation and amortization of clinic assets, certain marketing and promotional expenses and costs of goods sold.

Research and Development and Advertising Costs

Research and development and advertising costs are expensed as incurred and are included in general and administrative expenses. Research and development costs amounted to \$70 thousand and \$48 thousand for three months ended June 30, 2019 and 2018, respectively, and \$167 thousand and \$97 thousand for the six months ended June 30, 2019 and 2018, respectively. Advertising costs were \$1,022 thousand and \$1,418 thousand for the three months ended June 30, 2019 and 2018, respectively, and \$1,677 thousand and \$2,013 thousand for the six months ended June 30, 2019 and 2018, respectively. Advertising costs do not include trade marketing programs which are part of net sales.

Income taxes

The Company records a tax provision for the anticipated tax consequences of the reported results of operations. The provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax basis of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company may record a valuation allowance, if conditions are applicable, to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

Non-controlling interest

The non-controlling interests on the condensed consolidated statements of income represents the portion of earnings or loss attributable to the economic interest in the Company's subsidiary, Holdco, held by the non-controlling holders of Class B common stock and limited liability company interests in Holdco. Non-controlling interests on the condensed consolidated balance sheet represents the portion of net assets of the Company attributable to the non-controlling holders of Class B common stock and limited liability company interests in Holdco, based on the portion of the LLC Interests owned by holders of Class B common stock and limited liability company interests in Holdco. As of June 30, 2019 and December 31, 2018 the non-controlling interest was approximately 19.4% and 23.2%, respectively.

Litigation

The Company is subject to various legal proceedings, claims, litigation, investigations and contingencies arising out of the ordinary course of business. If the likelihood of an adverse legal outcome is determined to be probable and the amount of loss is estimable, then a liability is accrued in accordance with accounting guidance for Contingencies. If the assessment indicates a potentially material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, is disclosed. The Company consults with both internal and external legal counsel related to litigation.

Adopted Accounting Standard Updates

In February 2016, the FASB issued ASU 2016-02, *Leases*. The Company adopted the provisions of this guidance effective January 1, 2019, using the modified retrospective optional transition method. Therefore, the standard was applied beginning January 1, 2019 and prior periods were not restated. The adoption of the standard did not result in a cumulative-effect adjustment to the opening balance of accumulated deficit. The Company elected the package of practical expedients and implemented internal controls and system functionality to enable the preparation of financial information upon adoption. In addition, the Company has elected to apply the practical expedient to not separate the lease and non-lease components for all of the Company's leases.

The adoption of the new standard resulted in the recognition of a right of use asset and short-term and long-term liabilities recorded on the Company's consolidated balance sheet related to operating leases. Accounting for finance leases remained substantially unchanged. In addition, the adoption of the standard did not have a material impact on the Company's results of operations or cash flows.

Note 2 – Business CombinationVIP Acquisition

On January 17, 2018, PetIQ, Inc. completed the acquisition of VIP from VIP Holdings, LLC (“VIPH” or the “Sellers”).

The fair value of the consideration is summarized as follows:

<i>\$'s in 000's</i>	Fair value
Current assets	\$ 15,617
Property, plant, and equipment	8,885
Other assets, net	295
Intangible assets - Customer relationships (20 year useful life)	77,200
Intangible assets - Brand names (10 year useful life)	9,600
Goodwill	112,643
Total assets	224,240
Current liabilities	22,908
Capital lease obligations	3,032
Total liabilities	25,940
Purchase price	\$ 198,300
Cash paid, net of cash acquired	\$ 92,082
LLC Interests and shares of Class B common stock	90,031
Guarantee note	10,000
Contingent notes	6,900
Post-closing working capital adjustment	(713)
Fair value of total consideration transferred	\$ 198,300

The definite-lived intangibles primarily relate to customer relationships and brand names. The \$86.8 million represents the fair value and will be amortized over the estimated useful lives of the assets through January 2038. Amortization expense for these definite-lived intangible assets for the three months ended June 30, 2019 and 2018 was \$1.1 million and \$1.2 million, respectively, and \$2.2 million for the six months ended June 30, 2019 and 2018, respectively.

Goodwill represents the future economic benefits that do not qualify for separate recognition and primarily includes the assembled workforce and other non-contractual relationships, as well as expected future synergies. Approximately \$49.8 million of the \$112.6 million of goodwill will not be tax deductible, and the remaining balance is expected to be deductible for tax purposes. Goodwill was allocated to the Products and Services segments.

HBH Enterprises

On October 17, 2018, the Company completed the acquisition of HBH Enterprises, LLC (“HBH”) (the “HBH Acquisition”). Total consideration, net of cash acquired, was approximately \$14.7 million consisting of cash of \$1.7 million and equity consideration of approximately \$13.0 million. The equity consideration consisted 400 thousand LLC interests of Holdco and 400 thousand shares of Class B common stock, \$0.001 par value per share, of the Company.

The estimate of fair value and purchase price allocation were based on information available at the time of closing the HBH Acquisition and the Company continues to evaluate the underlying inputs and assumptions. The Company is in process of finalizing certain liabilities included in working capital. Accordingly, these liability preliminary estimates are subject to adjustments during the measurement period, not to exceed one year, based upon new information obtained about facts and circumstances that existed as of the date of closing the HBH Acquisition. The purchase price allocation has been allocated as follows:

<i>\$'s in 000's</i>		Preliminary Estimated Fair Value
Working Capital, net	\$	1,676
Property, plant, and equipment		2,686
Intangible assets - Customer relationships		3,800
Goodwill		7,607
Total assets		15,769
Capital lease obligations		1,114
Total liabilities		1,114
Estimated purchase price	\$	14,655
Cash paid, net of cash acquired	\$	1,683
LLC Interests and shares of Class B common stock		12,972
Estimated fair value of total consideration transferred	\$	14,655

Goodwill represents the future economic benefits that do not qualify for separate recognition and primarily includes the assembled workforce and other non-contractual relationships, as well as expected future synergies. Approximately \$5.0 million of the \$7.6 million of goodwill will not be tax deductible, and the remaining balance is expected to be deductible for tax purposes. Goodwill was allocated to the Products segment.

Note 3 – Property, Plant, and Equipment

Property, plant, and equipment consists of the following at:

<i>\$'s in 000's</i>	June 30, 2019	December 31, 2018
Leasehold improvements	\$ 11,081	\$ 10,776
Equipment	15,320	14,477
Vehicles and accessories	4,043	3,989
Computer equipment and software	6,694	5,839
Buildings	2,474	2,479
Furniture and fixtures	1,652	1,547
Land	660	660
Construction in progress	826	682
	<u>42,750</u>	<u>40,449</u>
Less accumulated depreciation	(16,447)	(13,114)
Total property, plant, and equipment	<u>\$ 26,303</u>	<u>\$ 27,335</u>

Depreciation expense related to these assets was \$1.5 million and \$1.8 million for the three months ended June 30, 2019 and 2018, respectively, and \$3.2 million and \$3.0 million for the six months ended June 30, 2019 and 2018, respectively.

Note 4 – Intangible Assets and Goodwill

Intangible assets consist of the following at:

<i>\$'s in 000's</i>	<u>Useful Lives</u>	<u>June 30, 2019</u>	<u>December 31, 2018</u>
Amortizable intangibles			
Distribution agreement	2 years	\$ 3,021	\$ 3,021
Certification	7 years	350	350
Customer relationships	12-20 years	82,123	82,124
Patents and processes	10 years	1,901	1,900
Brand names	10-15 years	10,470	10,470
Total amortizable intangibles		<u>97,865</u>	<u>97,865</u>
Less accumulated amortization		<u>(12,386)</u>	<u>(9,835)</u>
Total net amortizable intangibles		85,479	88,030
Non-amortizable intangibles			
Trademarks and other		516	516
Intangible assets, net of accumulated amortization		<u>\$ 85,995</u>	<u>\$ 88,546</u>

Certain intangible assets are denominated in currencies other than the U.S. Dollar; therefore, their gross and net carrying values are subject to foreign currency movements. Amortization expense for the three months ended June 30, 2019 and 2018 was \$1.3 million and \$1.3 million, respectively, and \$2.6 million and \$2.4 million for the six months ended June 30, 2019 and 2018, respectively.

Estimated future amortization expense for each of the following years is as follows:

<u>Years ending December 31, (\$'s in 000's)</u>	
Remainder of 2019	\$ 2,545
2020	6,641
2021	6,744
2022	6,723
2023	6,253
Thereafter	56,573

The following is a summary of the changes in the carrying value of goodwill for the period from January 1, 2018 to June 30, 2019:

(\$'s in 000's)	Reporting Unit		Total
	Products	Services	
Goodwill as of January 1, 2018	\$ 5,064	\$ —	\$ 5,064
Foreign currency translation	(285)	—	(285)
Acquisitions	72,986	47,264	120,250
Goodwill as of December 31, 2018	77,765	47,264	125,029
Foreign currency translation	11	—	11
Goodwill as of June 30, 2019	\$ 77,776	\$ 47,264	\$ 125,040

Note 5 – Debt

A&R Credit Agreement

In connection with the VIP Acquisition, the Company amended and restated its existing revolving credit agreement (the “A&R Credit Agreement”) on January 17, 2018, which was subsequently amended in August 2018. The A&R Credit Agreement provides for a secured revolving credit facility of \$75 million in the aggregate, at either LIBOR or Base (prime) interest rates plus an applicable margin. The A&R Credit Agreement matures on January 17, 2023 and contains a lockbox mechanism.

All obligations under the A&R Credit Agreement are unconditionally guaranteed by Holdco and each of its domestic wholly-owned subsidiaries and, subject to certain exceptions, each of its material current and future domestic wholly-owned subsidiaries. All obligations under the A&R Credit Agreement, and the guarantees of those obligations, are secured by substantially all of the assets of each borrower and guarantor under the A&R Credit Agreement, subject to certain exceptions.

Also in connection with the closing of the VIP Acquisition, the Company entered into a term loan credit agreement (the “Term Loan Credit Agreement”). The Term Loan Credit Agreement provides for a secured term loan credit facility of \$75 million in aggregate at either LIBOR or Base (prime) interest rates plus an applicable margin. The Term Loan Credit Agreement requires quarterly principal payments, with the full balance due on January 17, 2023.

As of June 30, 2019, the Company had \$5.1 million outstanding under the A&R Credit Agreement and \$74.3 million under the Term Loan Credit Agreement. The interest rate on the A&R Credit Agreement was 5.5% as a Base Rate loan, the interest rate on the Term Loan Credit Agreement was 7.7% as a LIBOR rate loan. Additionally the Company pays between 0.375% and 0.50% as an unused facility fee, depending on the amount borrowed.

The A&R Credit Agreement and Term Loan Credit Agreement contain certain covenants and restrictions including a fixed charge coverage ratio and a minimum EBITDA target and is secured by collateral consisting of a percentage of eligible accounts receivable, inventories, and machinery and equipment. As of June 30, 2019, the Company was in compliance with these covenants.

Other Debt

The Company entered into a mortgage with a local bank to finance \$1.9 million of the purchase price of a commercial building in Eagle, Idaho, in July 2017. The mortgage bears interest at a fixed rate of 4.35% and utilizes a 25 year amortization schedule with a 10 year balloon payment of the balance due at that time.

In connection with the VIP Acquisition, the Company entered into a guarantee note which requires the Company to pay \$10.0 million to the sellers on July 17, 2023. The note bears interest at a fixed 6.75% and requires quarterly interest payments. As of December 31, 2018, \$7.5 million was payable pursuant to the 2018 Contingent Note and up to \$10 million may be payable pursuant to the 2019 Contingent Note, collectively, “Notes Payable – VIP Acquisition” of \$17.5

million. See “Note – 2 Business Combinations”. The \$7.5 million note requires quarterly interest payments of 6.75% with the balance payable July 17, 2023. The following represents the Company’s long-term debt as of:

<i>\$'s in 000's</i>	<u>June 30, 2019</u>	<u>December 31, 2018</u>
Term loans	\$ 74,250	\$ 74,625
Revolving credit facility	5,137	13,452
Mortgage	1,836	1,859
Contingent note	3,460	2,680
Notes Payable - VIP Acquisition	17,500	17,500
Net discount on debt and deferred financing fees	(1,663)	(1,902)
	<u>\$ 100,520</u>	<u>\$ 108,214</u>
Less current maturities of long-term debt	(797)	(796)
Total long-term debt	<u>\$ 99,723</u>	<u>\$ 107,418</u>

Future maturities of long-term debt, excluding the Contingent note and net discount on debt and deferred financing fees and the contingent note, as of June 30, 2019, are as follows:

<i>(\$'s in 000's)</i>	
Remainder of 2019	\$ 398
2020	798
2021	800
2022	802
2023	94,317
Thereafter	1,608

The Company incurred debt issuance costs of \$0.1 million related to the A&R Credit Agreement and zero related to the Term Loan during the six months ended June 30, 2019.

Note 6 – Leases

The Company leases certain real estate for commercial, production, and retail purposes, as well as equipment from third parties. Lease expiration dates are between 2019 and 2025. A portion of leases are denominated in foreign currencies.

On January 1, 2019, the Company adopted ASU No. 2016-02, “Leases (Topic 842),” which requires most leases to be recognized on the balance sheet. The Company adopted the standard using the modified retrospective method and used the effective date as our date of initial adoption. Prior year financial statements were not restated under the new standard and, therefore, those amounts are not presented below. For both operating and finance leases, the Company recognizes a right-of-use asset, which represents the right to use the underlying asset for the lease term, and a lease liability, which represents the present value of our obligation to make payments arising over the lease term.

We elected the short-term lease exemption for all leases that qualify. This means leases having an initial term of twelve months or less are not recorded on the balance sheet and the related lease expense is recognized on a straight-line basis over the term of the lease.

The Company's leases may include options to extend or terminate the lease. Renewal options generally range from one to ten years and the options to extend are included in the lease term when it is reasonably certain that we will exercise that option. Some leases have variable payments, however, because they are not based on an index or rate, they are not included in the ROU assets and liabilities. Variable payments for real estate leases primarily relate to common area maintenance, insurance, taxes and utilities. Variable payments for equipment, vehicles, and leases within supply agreements primarily relate to usage, repairs, and maintenance. As the implicit rate is not readily determinable for most of the Company's leases, the Company applies a portfolio approach using an estimated incremental borrowing rate, giving consideration to company specific information and publicly available interest rates for instruments with similar characteristics, to determine the initial present value of lease payments over the lease terms.

The effect of the changes made to our consolidated balance sheet as of January 1, 2019 for the adoption of the new lease standard was as follows:

<i>\$'s in 000's</i>	<u>Balance at December 31, 2018</u>	<u>Adjustments due to ASC 842</u>	<u>Balance at January 1, 2019</u>
ASSETS			
Property and equipment, net ⁽¹⁾	\$ 27,335	\$ —	\$ 27,335
Operating lease right-of-use assets	—	10,424	10,424
Other non-current assets	\$ 2,857	\$ (116)	\$ 2,741
LIABILITIES			
Current portion of operating leases	\$ —	\$ 2,921	\$ 2,921
Operating Leases, less current installments	—	7,644	7,644
Current portion of long-term debt and finance leases ⁽²⁾	2,251	—	2,251
Finance leases, less current installments	2,319	—	\$ 2,319
Other non-current liabilities	\$ 524	\$ (257)	\$ 267

(1) Finance lease right-of-use assets of \$4.5 million are included in property and equipment, net, on the condensed consolidated balance sheets.

(2) Current portion of long-term debt and finance leases includes \$1.5 million of current portion of finance leases.

In accordance with the new lease standard requirements, the disclosure of the impact of adoption on our consolidated balance sheet was as follows:

<i>\$'s in 000's</i>	<u>June 30, 2019</u>		
	<u>As Reported</u>	<u>Balance without adoption of ASC 842</u>	<u>Effect of change</u>
ASSETS			
Property and equipment, net ⁽¹⁾	\$ 26,303	\$ 26,303	\$ —
Operating lease right-of-use assets	11,990	—	(11,990)
Other non-current assets	\$ 2,896	\$ 2,983	\$ 87
LIABILITIES			
Current portion of operating leases	\$ 3,306	\$ —	\$ (3,306)
Operating leases, less current installments	8,895	—	(8,895)
Current portion of long-term debt and finance leases ⁽²⁾	2,338	2,338	—
Finance leases, less current installments	1,768	1,768	—
Other non-current liabilities	\$ 254	\$ 494	\$ 240

(1) Finance lease right-of-use assets of \$4.2 million are included in property and equipment, net, on the condensed consolidated balance sheets.

(2) Current portion of long-term debt and finance leases includes \$1.5 million of current portion of finance leases.

<i>\$'s in 000's</i>	Three Months Ended	Six Months Ended
	June 30, 2019	June 30, 2019
Finance lease cost		
Amortization of right-of-use assets	\$ 411	\$ 701
Interest on lease liabilities	59	109
Operating lease cost	961	1,871
Variable lease cost ⁽¹⁾	115	187
Short-term lease cost	5	19
Total lease cost	<u>\$ 1,551</u>	<u>\$ 2,887</u>

(1) Variable lease cost primarily relates to common area maintenance, property taxes and insurance on leased real estate.

Other information related to leases was as follows as of:

	June 30, 2019
Weighted-average remaining lease term (years)	
Operating leases	3.88
Finance leases	2.54
Weighted-average discount rate	
Operating leases	5.0%
Finance leases	5.5%

Annual future commitments under non-cancelable leases as of June 30, 2019, consist of the following:

<i>\$'s in 000's</i>	Lease Obligations	
	Operating Leases	Finance Leases
Remainder of 2019	\$ 1,916	\$ 822
2020	3,952	1,362
2021	2,499	686
2022	2,325	521
2023	2,004	144
Thereafter	28	19
Total minimum future obligations	<u>\$ 12,724</u>	<u>\$ 3,554</u>
Less interest	(523)	(246)
Present value of net future minimum obligations	12,201	3,308
Less current lease obligations	(3,306)	(1,540)
Long-term lease obligations	<u>\$ 8,895</u>	<u>\$ 1,768</u>

Supplemental cash flow information:

<i>\$'s in 000's</i>	Six Months Ended	
	June 30, 2019	
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from finance leases	\$	109
Operating cash flows from operating leases		1,800
Financing cash flows from finance leases		737
(Noncash) right-of-use assets obtained in exchange for lease obligations		
Operating leases		1,566
Finance leases		315

Annual future commitments under non-cancelable leases as of December 31, 2018 under ASC 840 were:

<i>\$'s in 000's</i>	Lease Obligations	
	Operating Leases	Capital Leases
2019	\$ 3,318	\$ 1,615
2020	2,685	1,296
2021	1,894	605
2022	1,765	433
2023	1,478	123
Thereafter	134	—
Total minimum future obligations	<u>\$ 11,274</u>	<u>\$ 4,072</u>
Less imputed interest		(298)
Total lease obligations		<u>3,774</u>
Less current obligations		(1,455)
Long-term lease obligations		<u>\$ 2,319</u>

Note 7 – Income Tax

As a result of the IPO and related reorganization transactions completed in July 2017, the Company held a majority of the economic interest in Holdco and consolidates the financial position and results of Holdco. The remaining ownership of Holdco not held by the Company is considered a non-controlling interest. Holdco is treated as a partnership for income tax reporting. Holdco's members, including the Company, are liable for federal, state, and local income taxes based on their share of Holdco's taxable income.

Our effective tax rate (ETR) from continuing operations was 13.0% and 14.3% for the three and six months ended June 30, 2019, respectively and 16.0% and (3.3)% for the three and six months ended June 30, 2018, respectively. Income tax expense for the three and six months ended June 30, 2019 and 2018 was different than the U.S federal statutory income tax rate of 21% primarily due to the impact of the non-controlling interest income that is not taxable.

HoldCo makes cash distributions to members to pay taxes attributable to their allocable share of income earned. In the three and six months ended June 30, 2019, the Company made cash distributions of \$1 thousand and \$1.4 million, respectively. In the three and six months ended June 30, 2018, the Company made cash distributions of \$32 thousand and \$0.6 million, respectively. Additionally, HoldCo accrues for distributions required to be made related to estimated income taxes. During the three and six months ended June 30, 2019, the Company accrued \$0.8 million and \$1.1 million, respectively and during the three and six months ended June 30, 2018, the Company accrued \$0.3 million and \$0.7 million, respectively.

Note 8 – Earnings per Share

Basic and Diluted Earnings (Loss) per Share

Basic earnings per share of Class A common stock is computed by dividing net income available to PetIQ, Inc. by the weighted-average number of shares of Class A common stock outstanding during the period. Diluted earnings per share of Class A common stock is computed by dividing net income available to PetIQ, Inc. by the weighted-average number of shares of Class A common stock outstanding adjusted to give effect to potentially dilutive securities.

The following table sets forth reconciliations of the numerators and denominators used to compute basic and diluted earnings per share of Class A common stock:

<i>(in 000's, except for per share amounts)</i>	Three months ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Numerator:				
Net income	\$ 5,918	\$ 5,398	\$ 8,244	\$ 1,441
Less: net income attributable to non-controlling interests	2,103	2,899	2,818	970
Net income attributable to PetIQ, Inc. — basic and diluted	3,815	2,499	5,426	471
Denominator:				
Weighted-average shares of Class A common stock outstanding -- basic	22,365	15,980	22,087	15,285
Dilutive effects of stock options that are convertible into Class A common stock	215	28	188	43
Dilutive effect of RSUs	17	—	9	—
Weighted-average shares of Class A common stock outstanding -- diluted	22,597	16,008	22,284	15,329
Earnings per share of Class A common stock — basic	\$ 0.17	\$ 0.16	\$ 0.25	\$ 0.03
Earnings per share of Class A common stock — diluted	\$ 0.17	\$ 0.16	\$ 0.24	\$ 0.03

Shares of the Company's Class B common stock do not share in the earnings or losses of the Company and are therefore not participating securities. As such, separate presentation of basic and diluted earnings per share of Class B common stock under the two-class method has not been presented.

For the three and six months ended June 30, 2019 and 2018, all shares of the Company's Class B common stock have not been included in the diluted earnings per share calculation as they have been determined to be anti-dilutive under the if-converted method, respectively.

Additionally, 1,180 thousand and 1,550 thousand stock options and restricted stock units have not been included in the diluted earnings per share calculation for the three and six months ended June 30, 2019, respectively, as they have been determined to be anti-dilutive under the treasury stock method. For the three and six months ended June 30, 2018, 1,039 thousand stock options and restricted stock units have not been included in the diluted earnings per share calculation as they have been determined to be anti-dilutive under the treasury stock method.

Note 9 – Stock Based Compensation

PetIQ, Inc. Omnibus Incentive Plan

The PetIQ, Inc. Omnibus Incentive Plan (the "Plan") provides for the grant of various equity-based incentive awards to directors of the Company, employees, and consultants. The types of equity-based awards that may be granted under the Plan include: stock options, stock appreciation rights (SARs), restricted stock, restricted stock units (RSUs), and other stock-based awards. The Company initially reserved 1,914 thousand registered shares of Class A common stock for issuance under the Plan, and subsequently authorized an additional 2,000 thousand at the 2019 annual meeting for a total of 3,914 thousand authorized shares. As of June 30, 2019, 1,889 thousand shares were available for issuance under the Plan. All awards issued under the Plan may only be settled in shares of Class A common stock.

PetIQ, Inc. 2018 Inducement and Retention Stock Plan for CVC Employees

The PetIQ, Inc. 2018 Inducement and Retention Stock Plan for CVC Employees (the “Inducement Plan”) provides for the grant of stock options to employees hired in connection with the VIP Acquisition as employment inducement awards pursuant to NASDAQ Listing Rule 5635(c)(4). The Inducement Plan reserved 800 thousand shares of Class A Common Stock of the Company. As of June 30, 2019, no shares were available for issuance under the Inducement Plan. All awards issued under the Plan may only be settled in shares of Class A common stock.

Stock Options

The Company awards stock options to certain employees and directors under the Plan and the Inducement Plan, which are subject to time-based vesting conditions, typically 25% on each anniversary of the grant date until fully vested. Upon a termination of service relationship by the Company, all unvested options will be forfeited and the shares of common stock underlying such awards will become available for issuance under the Plan. The maximum contractual term for stock options is 10 years.

The fair value of these equity awards is amortized to equity based compensation expense over the vesting period, which totaled \$1.3 million and \$2.6 million for the three and six months ended June 30, 2019, respectively and \$0.7 million and \$1.4 million for the three and six months ended June 30, 2018, respectively. All stock based compensation expense is included in general and administrative expenses based on the role of recipients. The fair value of the stock option awards were determined on the grant dates using the Black-Scholes valuation model based on the following weighted-average assumptions for the periods ended June 30, 2019 and 2018:

	<u>June 30, 2019</u>	<u>June 30, 2018</u>
Expected term (years) ⁽¹⁾	6.25	6.25
Expected volatility ⁽²⁾	35.00 %	35.00 %
Risk-free interest rate ⁽³⁾	2.74 %	2.53 %
Dividend yield ⁽⁴⁾	0.00 %	0.00 %

- (1) The Company utilized the simplified method to determine the expected term of the stock options since we do not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term.
- (2) The expected volatility assumption was calculated based on a peer group analysis of stock price volatility with a look back period consistent with the expected option term.
- (3) The risk-free interest rate was based on the U.S. Treasury yield curve in effect at the time of grant, which corresponds to the expected term of the stock options.
- (4) The Company has not paid and does not anticipate paying a cash dividend on our common stock.

The following table summarizes the activity of the Company’s unvested stock options for the period ended June 30, 2019.

	<u>Stock Options (in 000's)</u>	<u>Weighted Average Exercise Price</u>	<u>Aggregate Intrinsic Value</u>	<u>Weighted Average Remaining Contractual Life (years)</u>
Outstanding at December 31, 2018	1,945	\$ 23.45	5,527	9.1
Granted	419	27.50		
Exercised	(38)	20.80		
Forfeited	(49)	21.72		
Cancelled/Expired	(1)	21.37		
Outstanding at June 30, 2019	2,276	\$ 24.28	\$ 20,700	8.8
Options exercisable at June 30, 2019	332			

The weighted average grant date fair value of stock options granted during the period ended June 30, 2019 was \$10.82 per option. At June 30, 2019, total unrecognized compensation cost related to unvested stock options was \$16.9 million and is expected to be recognized over a weighted-average period of 3.0 years.

Restricted Stock Units

The Company awards RSUs to certain employees and directors under the Plan, which are subject to time-based vesting conditions. Upon a termination of service relationship by the Company, all unvested RSUs will be forfeited and the shares of common stock underlying such awards will become available for issuance under the Plan. The fair value of RSUs are measured based on the closing fair market value of the Company's common stock on the date of grant. At June 30, 2019, total unrecognized compensation cost related to unvested RSUs was \$4.0 million and is expected to vest over a weighted average 3.5 years.

The fair value of these equity awards is amortized to equity based compensation expense over the vesting period, which totaled \$0.3 million and \$0.5 million for the three and six months ended June 30, 2019 and \$0.02 million and \$0.02 million for the three and six months ended June 30, 2018. All stock based compensation expense is included in general and administrative expenses based on the role of recipients.

The following table summarizes the activity of the Company's RSUs for the period ended June 30, 2019.

	Number of Shares (in 000's)	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2018	51	\$ 33.16
Granted	116	27.52
Settled	(8)	20.17
Forfeited	(3)	27.73
Nonvested RSUs at June 30, 2019	156	\$ 29.71

There were grants of 10 thousand RSUs for the six months ended June 30, 2018.

Note 10 – Stockholders' Equity

Acquisition

During the six months ended June 30, 2018 Holdco issued 4,200 thousand LLC Interests and Class B common shares as consideration for the VIP Acquisition.

Exchanges

During the six months ended June 30, 2019 holders of Class B common stock and LLC Interests exercised exchange rights and exchanged 1,085 thousand Class B common shares and corresponding LLC Interests for newly issued Class A Common Stock. The LLC Agreement generally allows for conversions on the last day of each calendar month.

Note 11 – Non-Controlling Interests

The following table presents the outstanding LLC Interests and changes in LLC Interests for the periods presented.

	LLC Interests held			% of Total	
	LLC			LLC	
	Owners	PetIQ, Inc.	Total	Owners	PetIQ, Inc.
As of December 31, 2018	6,547	21,620	28,167	23.2%	76.8%
Stock based compensation adjustments	—	46	46		
Exchange transactions	(1,085)	1,085	—		
As of June 30, 2019	5,462	22,750	28,212	19.4%	80.6%

Note that certain figures shown in the table above may not recalculate due to rounding.

For the three and six months ended June 30, 2019, the Company owned a weighted average of 79.3% and 78.4% of Holdco, respectively.

Note 12 – Customer Concentration

The Company has significant exposure to customer concentration. During the three and six months ended June 30, 2019 two customers individually accounted for more than 10% of sales, together comprising 34% and 34% of net sales, respectively, for such periods. During the three months ended June 30, 2018 one customer individually accounting for more than 10% of sales and 19% of net sales. In total for the six months ended June 30, 2018, three customers accounted for 41% of net sales, respectively.

At June 30, 2019 one Product Segment customer individually accounted for more than 10% of outstanding trade receivables, and in aggregate accounted for 50% of outstanding trade receivables, net. At December 31, 2018 one Product Segment customer, individually accounted for more than 10% of outstanding trade receivables, and in aggregate accounted for 43%, of outstanding trade receivables, net.

Note 13 – Commitments and Contingencies**Litigation Contingencies**

On April 4, 2018, Med Vets, Inc. and Bay Medical Solutions Inc. (collectively “Plaintiffs”) filed suit in the United States District Court for the Northern District of California against PetIQ and VIP Petcare Holdings, Inc. for alleged unlawful merger and other antitrust violations. On April 22, 2019, the Court granted the Company’s Motion to Dismiss without further leave to amend, concluding that Plaintiffs were not able to identify any factual allegations to support their alleged claims.

Plaintiffs filed a notice of appeal with 9th Circuit Court of Appeals on May 21, 2019. Appeal briefing will occur during late 2019 and early 2020.

The Company records a liability when a particular contingency is probable and estimable and provides disclosure for contingencies that are at least reasonably possible of resulting in a loss including an estimate which we currently cannot make. The Company has not accrued for any contingency at June 30, 2019 and December 31, 2018 as the Company does not consider any contingency to be probable or estimable. The Company expenses legal costs as incurred within general and administrative expenses on the consolidated condensed statements of operations.

Note 14 – Segments

Effective January 17, 2018, the Company has two operating segments: Products and Services. The Products segment consists of the Company’s manufacturing and distribution business. Services represents all veterinary services, and related product sales, provided by the Company directly to consumers. The segments are based on the discrete financial information reviewed by the Chief Operating Decision Maker to make resource allocation decisions and to evaluate performance. Certain corporate costs are not included in this analysis, such as accounting, legal, human resources, information technology and corporate headquarters expenses. Additionally certain expense types are allocated to the corporate portion of the Company, such as stock based compensation, amortization expense on intangible assets, interest

expense, foreign currency exchange adjustments, and income taxes. The period from January 1, 2018 to January 16, 2018 has been recast to reflect these reportable operating segments.

Financial information relating to the Company's operating segments for the three months ended:

<i>\$'s in 000's</i>				
June 30, 2019	Products	Services	Corporate	Consolidated
Net Sales	\$ 194,606	\$ 26,028	\$ —	\$ 220,634
Operating income (loss)	20,227	4,394	(15,631)	8,990
Interest expense	—	—	(2,242)	(2,242)
Foreign currency gain, net	—	—	49	49
Other income, net	—	—	2	2
Depreciation expense	429	520	580	1,529
Amortization expense	\$ —	\$ —	\$ 1,278	\$ 1,278

<i>\$'s in 000's</i>				
June 30, 2018	Products	Services	Corporate	Consolidated
Net Sales	\$ 148,713	\$ 22,429	\$ —	\$ 171,142
Operating income (loss)	16,156	1,951	(9,191)	8,916
Interest expense	—	—	(2,216)	(2,216)
Foreign currency gain, net	—	—	136	136
Other expense, net	—	—	(418)	(418)
Depreciation expense	688	702	390	1,780
Amortization expense	\$ —	\$ —	\$ 1,257	\$ 1,257

Financial information relating to the Company's operating segments for the six months ended:

<i>\$'s in 000's</i>				
June 30, 2019	Products	Services	Corporate	Consolidated
Net Sales	\$ 320,690	\$ 48,380	\$ —	\$ 369,070
Operating income (loss)	33,316	7,411	(26,864)	13,862
Interest expense	—	—	(4,179)	(4,179)
Foreign currency loss, net	—	—	(73)	(73)
Other income, net	—	—	15	15
Depreciation expense	982	1,045	1,156	3,183
Amortization expense	\$ —	\$ —	\$ 2,557	\$ 2,557

<i>\$'s in 000's</i>				
June 30, 2018	Products	Services	Corporate	Consolidated
Net Sales	\$ 246,564	\$ 39,644	\$ —	\$ 286,208
Operating income (loss)	25,105	1,595	(21,010)	5,690
Interest expense	—	—	(3,981)	(3,981)
Foreign currency gain, net	—	—	58	58
Other expense, net	—	—	(373)	(373)
Depreciation expense	1,150	1,249	631	3,030
Amortization expense	\$ —	\$ —	\$ 2,397	\$ 2,397

Supplemental geographic disclosures are below.

\$'s in 000's	Three months ended June 30, 2019		
	U.S.	Foreign	Total
Product segment sales	\$ 192,994	\$ 1,612	\$ 194,606
Service segment revenue	26,028	—	26,028
Total net sales	\$ 219,022	\$ 1,612	\$ 220,634

\$'s in 000's	Three months ended June 30, 2018		
	U.S.	Foreign	Total
Product segment sales	\$ 147,278	\$ 1,435	\$ 148,713
Service segment revenue	22,429	—	22,429
Total net sales	\$ 169,707	\$ 1,435	\$ 171,142

\$'s in 000's	Six months ended June 30, 2019		
	U.S.	Foreign	Total
Product sales	\$ 317,445	\$ 3,245	\$ 320,690
Service revenue	48,380	—	48,380
Total net sales	\$ 365,825	\$ 3,245	\$ 369,070

\$'s in 000's	Six months ended June 30, 2018		
	U.S.	Foreign	Total
Product sales	\$ 243,534	\$ 3,030	\$ 246,564
Service revenue	39,644	—	39,644
Total net sales	\$ 283,178	\$ 3,030	\$ 286,208

Property, plant, and equipment by geographic location is below.

	June 30, 2019	December 31, 2018
United States	\$ 25,284	\$ 26,268
Europe	1,019	1,067
Total	\$ 26,303	\$ 27,335

Note 15 – Related Parties

As discussed in Note 7– “Income Taxes”, the Company has accrued tax distributions that are payable to holders of Class B common stock and LLC Interests to facilitate the payment of periodic estimated tax obligations by such holders. At June 30, 2019, and December 31, 2018, the Company had an accrual of \$0.9 million and \$1.2 million, respectively, for estimated tax distributions, which are included in accounts payable on the condensed consolidated balance sheets.

As discussed in Note 5– “Debt”, the Company has notes payable to the sellers of VIP, who are significant shareholders of the Company, of \$17.5 million in aggregate as of June 30, 2019 and December 31, 2018 and accrued interest of \$169 thousand as of December 31, 2018. The Company paid \$270 thousand and \$171 thousand of interest in the three months ended June 30, 2019 and 2018 respectively. The Company paid \$692 thousand and \$257 thousand of interest in the six months ended June 30, 2019 and 2018, respectively. Additionally, up to \$10 million may be due under the 2019 Contingent note, in the event the note is earned.

The Company leases office and warehouse space from a company under common control of the sellers of VIP, commencing on January 17, 2018. The Company incurred rent expenses of \$91 thousand and \$183 thousand in the three and six months ended June 30, 2019, respectively. The Company incurred rent expenses of \$89 thousand and \$164 thousand in the three and six months ended June 30, 2018, respectively.

Chris Christensen, the brother of CEO, McCord Christensen, acts as the Company’s agent at Moreton Insurance (“Moreton”), which acts as a broker for a number of the Company’s insurance policies. The Company’s premium expense, paid to Moreton and subsequently transferred to insurance providers, was \$0 thousand and \$137 thousand for the three and six months ended June 30, 2019, respectively, and \$0 thousand and \$109 thousand for the three and six months ended June 30, 2018, respectively. Mr. Chris Christensen was paid a commission of approximately \$0 thousand

and \$7 thousand for the three and six months ended June 30, 2019, respectively, and \$5 thousand and \$0 thousand for the three and six months ended June 30, 2018, respectively, by Moreton for the sale of such insurance policies to the Company.

Note 16 – Subsequent events

On July 8, 2019, PetIQ (“the Buyer”) completed the acquisition of all of the outstanding capital stock of Sergeant’s Pet Care Products, Inc. (the “Acquisition”), including any assets related to the business, from L. Perrigo Company (“Seller”), resulting in the business becoming an indirect wholly-owned subsidiary of the Company (the “Acquisition”). The purchase price for the Acquisition is \$185 million in cash, subject to customary adjustments for net working capital, closing indebtedness and transaction expenses. The Company expects the acquisition to be integrated into its Products segment by the end of Q3 2019.

Buyer and its domestic subsidiaries amended their existing revolving credit agreement on July 8, 2019 (the “Credit Agreement Amendment”) to increase the size of the revolving facility to \$110 million with an accordion feature allowing an additional increase up to \$125 million and extend the maturity date of the revolving facility to July 8, 2024. In addition, the Credit Agreement Amendment reduces the interest rate on Eurodollar rate loans and modifies certain financial covenants, including eliminating the maximum first lien net coverage ratio.

On July 8, 2019 Buyer and its domestic subsidiaries entered into an amended and restated term loan credit agreement on July 8, 2019 (the “A&R Term Loan Credit Agreement”) with a secured term loan facility of \$220 million maturing on July 8, 2025, the proceeds of which were used to refinance the existing term loan facility and consummate the Acquisition.

All obligations under the A&R Term Loan Credit Agreement are unconditionally guaranteed by PetIQ Holdings, LLC and each of its domestic wholly-owned subsidiaries and, subject to certain exceptions, each of its material current and future domestic wholly-owned subsidiaries. All obligations under the A&R Term Loan Credit Agreement, and the guarantees of those obligations, are secured by substantially all of the assets of Buyer and each guarantor under the A&R Term Loan Credit Agreement, subject to certain exceptions.

The A&R Term Loan Credit Agreement contains a number of covenants that, among other things, restrict our and our subsidiaries’ ability to (subject to certain exceptions): (i) make investments, loans or advances; (ii) incur additional indebtedness; (iii) create liens on assets; (iv) engage in mergers or consolidations and/or sell assets; (v) pay dividends and distributions or repurchase our equity interests; (vi) repay subordinated indebtedness; (vii) make certain acquisitions; and (viii) other restrictions typical for a credit agreement of this type.

The A&R Term Loan Credit Agreement also contains certain customary affirmative covenants and events of default (including change of control). In addition, the A&R Term Loan Credit Agreement includes a maintenance covenant that requires compliance with a maximum first lien net leverage ratio. The availability of certain baskets and the ability to enter into certain transactions (including our ability to pay dividends) may also be subject to compliance with secured leverage ratios.

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

The following is a discussion of our results of operations and current financial condition. This should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and our audited consolidated financial statements for the year ended December 31, 2018 and related notes included in the annual report for PetIQ, Inc., filed with the Securities and Exchange Commission (the “SEC”) on Form 10-K for the year ended December 31, 2018. This discussion contains forward-looking statements that reflect our plans, estimates, and beliefs and involve numerous risks and uncertainties. Actual results may differ materially from those contained in any forward-looking statements. See “Cautionary Note Regarding Forward-Looking Statements.”

Our Business

Overview

PetIQ is a leading, rapidly growing pet health and wellness company. Through over 60,000 points of distribution across retail and e-commerce channels, PetIQ and VIP Petcare, a wholly-owned subsidiary, have a mission to make pet lives better by educating pet parents on the importance of offering regular, convenient access and affordable choices for pet preventative and wellness veterinary products and services. PetIQ believes that pets are an important part of the family and deserve the best products and care we can give them.

We are the sole managing member of PetIQ Holdings, LLC (“Holdco”), a Delaware limited liability company, which is the sole member of PetIQ, LLC (“Opco”) and, through Holdco, operate and control all of the business and affairs of Opco.

Our sales occur predominantly in the U.S. and Canada. Approximately 99% of our three and six months ended June 30, 2019 and 2018 net sales were generated from customers located in the United States and Canada, with the remaining sales generated from other foreign locations. We have two reporting segments: (i) Products; and (ii) Services. This is based on the level at which the chief operating decision maker reviews the results of operations to make decisions regarding performance assessment and resource allocation.

Results of Operations

Components of our Results of Operations

Net Sales

Our product net sales consist of our total sales net of product returns, allowances (discounts), trade promotions and incentives. We offer a variety of trade promotions and incentives to our customers, such as cooperative advertising programs and in-store displays. We recognize revenue upon satisfaction of the performance obligation in accordance with the terms of our contracts. Trade promotions are used to increase our aggregate net sales. Our net sales are periodically influenced by the timing, extent and amount of such trade promotions and incentives.

Key factors that may affect our future sales growth include: new product introductions; expansion into e-commerce and other customer bases; expansion of items sold to existing customers, addition of new retail customers and to maintain pricing levels necessary for profitability; aggressive pricing by our competitors; and whether we can maintain and develop positive relationships with key retail customers.

Our products are primarily consumables and, as such, they experience a replenishment cycle.

Our service revenue consists of providing veterinary services for consumers and selling products to the consumer in conjunction with those services. The customer renders payment at the time the service is rendered.

While many of our products are sold consistently throughout the year, we experience seasonality in the form of increased retailer demand for our flea and tick product offerings in the first two quarters of the year in preparation for increased

consumer demand during the summer months. Additionally our veterinary services experience seasonality as consumers typically seek more services in the warmer months.

Gross Profit

Gross profit is our net product sales plus service revenue less cost of product sales and services. Our cost of product sales consists primarily of costs of raw goods, finished goods packaging materials, manufacturing, shipping and handling costs and costs associated with our warehouses and distribution network. Cost of services are comprised of all service and product costs related to providing veterinary services, including but not limited to, salaries of veterinarians, technicians and other clinic based personnel, transportation and delivery costs, facilities rent, occupancy costs, supply costs, depreciation and amortization of clinic assets, certain marketing and promotional expenses and costs of goods sold.

Gross margin measures our gross profit as a percentage of net sales. With respect to our proprietary products, we have a manufacturing network that includes leased manufacturing facilities where we manufacture finished goods, as well as third-party contract manufacturing facilities from which we purchase finished products predominately on a dollar-per-unit basis. The gross margin on our proprietary value-branded products is higher than on our distributed products. For distributed products, our costs are driven largely by whether we source the product direct from the manufacturer or a licensed distributor. Gross profit in the services segment is driven by the number of pets that seek services in the individual clinics due to the relatively fixed cost nature of providing the clinic.

General and Administrative Expenses

Our general and administrative expenses primarily consist of employee compensation and benefits expenses, sales and merchandizing expenses, advertising and marketing expenses, rent and lease expenses, IT and utilities expenses, professional fees, insurance costs, R&D costs, host fees, banking charges, and consulting fees. In the future, we expect our general and administrative expenses to grow at a slower rate than our net sales growth as we leverage our past investments.

Our advertising and marketing expenses primarily consist of digital marketing (e.g. search engine optimization, pay-per-click, content marketing, etc.), social media, in-store merchandising and trade shows in an effort to promote our brands and build awareness. These expenses may vary from quarter to quarter but typically they are higher in the second and third quarters. We expect our marketing and advertising expenses to decrease as a percentage of net sales as we continue to concentrate campaigns to relevant markets, as well as shift spending towards in-store marketing and customer trade-supported programs.

Net Income

Our net income for future periods will be affected by the various factors described above as well as the impact on our tax rate from our fluctuating ownership of Holdco.

Results of Operations

The following table sets forth our consolidated statements of income in dollars and as a percentage of net sales for the periods presented:

<i>\$'s in 000's</i>	For the Three Months Ended		% of Net Sales	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Product sales	\$ 194,606	\$ 148,713	88.2 %	86.9 %
Services revenue	26,028	22,429	11.8 %	13.1 %
Total net sales	220,633	171,142	100.0 %	100.0 %
Cost of products sold	167,845	127,583	76.1 %	74.5 %
Cost of services	17,889	17,241	8.1 %	10.1 %
Total cost of sales	185,733	144,824	84.2 %	84.6 %
Gross profit	34,900	26,318	15.8 %	15.4 %
General and administrative expenses	24,450	16,943	11.1 %	9.9 %
Contingent note revaluations loss	1,460	459	0.7 %	0.3 %
Operating income	8,990	8,916	4.1 %	5.2 %
Interest expense, net	(2,242)	(2,216)	(1.0)%	(1.3)%
Foreign currency loss, net	49	136	0.0 %	0.1 %
Other income, net	2	(418)	0.0 %	(0.2)%
Total other expense, net	(2,191)	(2,498)	(1.0)%	(1.5)%
Pretax net income	6,799	6,418	3.1 %	3.8 %
Income tax expense	(881)	(1,020)	(0.4)%	(0.6)%
Net income	\$ 5,918	\$ 5,398	2.7 %	3.2 %

<i>\$'s in 000's</i>	For the Six Months Ended		% of Net Sales	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Product sales	\$ 320,690	\$ 246,564	86.9 %	86.1 %
Service revenue	48,380	39,644	13.1 %	13.9 %
Total sales	369,069	286,208	100.0 %	100.0 %
Cost of products sold	275,909	212,169	74.8 %	74.1 %
Cost of services	33,531	31,838	9.1 %	11.1 %
Total cost of sales	309,439	244,007	83.8 %	85.3 %
Gross profit	59,630	42,201	16.2 %	14.7 %
General and administrative expenses	44,988	35,911	12.2 %	12.5 %
Contingent note revaluation loss	780	600	0.2 %	0.2 %
Operating income	13,862	5,690	3.8 %	2.0 %
Interest expense, net	(4,179)	(3,981)	(1.1)%	(1.4)%
Foreign currency gain/(loss), net	(73)	58	(0.0)%	0.0 %
Other (expense) income, net	15	(373)	0.0 %	(0.1)%
Total other expense, net	(4,237)	(4,296)	(1.1)%	(1.5)%
Pretax net income	9,625	1,394	2.6 %	0.5 %
(Provision) benefit from income taxes	(1,381)	47	(0.4)%	0.0 %
Net income	\$ 8,244	\$ 1,441	2.2 %	0.5 %

Three Months Ended June 30, 2019 Compared With Three Months Ended June 30, 2018

Net sales

Product sales increased \$45.9 million or 31%, to \$194.6 million for the three months ended June 30, 2019, compared to \$148.7 million for the three months ended June 30, 2018. This increase was driven by expanding item count at existing customers of existing items, as well as customer program expansion.

Service revenue was \$26.0 million in the three months ended June 30, 2019 and \$22.4 million in the three months ended June 30, 2018. The Services growth in services is driven by opening of new wellness centers and increasing pet counts within existing community clinics.

Gross profit

Gross profit increased by \$8.6 million, or 33%, to \$34.9 million for the three months ended June 30, 2019, compared to \$26.3 million for the three months ended June 30, 2018. This increase is due to the significant sales growth, the operational improvements made in the services segment by rationalizing unproductive clinics, economies of scale realized in the product segment, offset by product sales mix.

Gross margin increased to 15.8% for the three months ended June 30, 2019, from 15.4% for the three months ended June 30, 2018.

General and administrative expenses

General and administrative expenses increased by \$7.5 million or 44% to \$24.5 million for the three months ended June 30, 2019 compared to \$16.9 million for the three months ended June 30, 2018. As a percentage of net sales, general and administrative expenses increased from 9.9% in the second three months of 2018 to 11.1% for the second three months of 2019, primarily driven by costs related to the acquisition of Sergeants and overall expansion of corporate services. The increase in total expense reflects:

- Increased stock based compensation expense on additional grants supporting company growth of approximately \$0.8 million;
- Increased compensation and benefits to support overall company growth, the addition of the HBH subsidiary, leadership transition costs including severance and signing bonuses, and the adoption of harmonized benefits across the entire organization;
- Increased professional service costs including legal and accounting to support the growth of the business; and
- Increased acquisition expenses related to the Sergeants Acquisition.

Pre-tax net income

As a result of the factors above, pre-tax net income increased \$0.4 million to \$6.8 million for the three months ended June 30, 2019 compared to pre-tax net income of \$6.4 million for the three months ended June 30, 2018.

Provision for income taxes

Our effective tax rate was 13.0% and 16.0% for the three months ended June 30, 2019 and 2018, respectively, with tax expense of \$0.9 million and \$1.0 million. The Company's tax rate is impacted by the ownership structure, which changes over time.

Six Months Ended June 30, 2019 Compared With Six Months Ended June 30, 2018

Net sales

Product sales increased \$74.1 million or 30%, to \$320.7 million for the six months ended June 30, 2019, compared to \$246.6 million for the six months ended June 30, 2018. This increase was driven by expanding item count at existing customers of existing items, as well as customer program expansion.

Service revenue was \$48.4 million in the six months ended June 30, 2019 and \$39.6 million in the six months ended June 30, 2018. The growth was led by the opening of multiple wellness centers through 2018, as well as several openings in 2019. Additionally the Company has seen rising pet counts within existing community clinics.

Gross profit

Gross profit increased by \$17.4 million, or 41%, to \$59.6 million for the six months ended June 30, 2019, compared to \$42.2 million for the six months ended June 30, 2018. This increase is due to the significant sales growth, the operational improvements made in the services segment by rationalizing unproductive clinics, economies of scale within the product segment, offset by product sales mix.

Gross margin decreased to 16.2% for the six months ended June 30, 2019, from 14.7% for the six months ended June 30, 2018.

General and administrative expenses

General and administrative expenses increased by \$9.1 million or 25% to \$45.0 million for the six months ended June 30, 2019 compared to \$35.9 million for the six months ended June 30, 2018. The increase in total expense reflects:

- Increased stock based compensation expense on additional grants supporting company growth of approximately \$1.7 million;
- Increased compensation and benefits to support overall company growth, leadership transition costs including severance and signing bonuses, the addition of the HBH subsidiary, and the adoption of harmonized benefits across the entire organization;
- Increased professional service costs including legal and accounting to support the growth of the business; and
- Higher costs related to higher sales such as host fees, merchant fees and other selling costs.

Interest expense, net

Interest expense, net increased \$0.2 million to \$4.2 million for the six months ended June 30, 2019, compared to \$4.0 million for the six months ended June 30, 2018. This increase was driven by increasing rates on variable rate debt, offset by additional interest income from the Company's cash and cash equivalents related to the public offering that was completed in October of 2018.

Pre-tax net income

As a result of the factors above, pre-tax net income increased \$8.2 million to \$9.6 million for the six months ended June 30, 2019 compared to \$1.4 million for the six months ended June 30, 2018.

Provision for income taxes

Our effective tax rate was 14.3% and (3.4)% for the six months ended June 30, 2019 and 2018, respectively, with tax expense of \$1.4 million and a tax benefit of \$0.05 million. The Company's tax rate is impacted by the ownership structure, which changes over time.

Non-GAAP Financial Measures

EBITDA and Adjusted EBITDA are non-GAAP financial measures. EBITDA represents net income before interest, income taxes and depreciation and amortization. Adjusted EBITDA represents EBITDA plus acquisition costs, stock based compensation expense, purchase accounting inventory adjustment, fair value adjustment to contingent consideration, new clinic launch expenses, integration and costs of discontinued clinics, and operations of non same-store operations as defined below. Adjusted EBITDA adjusts for transactions that management does not believe are representative of our core ongoing business. Adjusted EBITDA is utilized by management: (i) as a factor in evaluating management's performance when determining incentive compensation and (ii) to evaluate the effectiveness of our business strategies.

The Company presents EBITDA because it is a necessary component for computing Adjusted EBITDA. We believe that the use of EBITDA and Adjusted EBITDA provides an additional tool for investors to use in evaluating ongoing operating results and trends. In addition, you should be aware when evaluating EBITDA and Adjusted EBITDA that in the future we may incur expenses similar to those excluded when calculating these measures. Our presentation of these measures should not be construed as an inference that our future results will be unaffected by these or other unusual or non-recurring items. Our computation of EBITDA and Adjusted EBITDA may not be comparable to other similarly titled measures computed by other companies, because all companies do not calculate EBITDA and Adjusted EBITDA in the same manner.

Our management does not, and you should not, consider EBITDA or Adjusted EBITDA in isolation or as an alternative to financial measures determined in accordance with GAAP. The principal limitation of EBITDA and Adjusted EBITDA is that they exclude significant expenses and income that are required by GAAP to be recorded in our financial statements. Some of these limitations are:

- EBITDA does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual commitments;
- EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- EBITDA does not reflect the interest expenses, or the cash requirements necessary to service interest or principal payments, on our debts;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;
- Adjusted EBITDA does not reflect the impact of certain cash charges resulting from matters we consider not to be indicative of our ongoing core operations; and
- Other companies in our industry may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, EBITDA and Adjusted EBITDA should not be considered in isolation or as a substitute for performance measures calculated in accordance with GAAP. We compensate for these limitations by relying primarily on our GAAP results and using EBITDA and Adjusted EBITDA only supplementally. You should review the reconciliations of net (loss) income to EBITDA and Adjusted EBITDA below and not rely on any single financial measure to evaluate our business.

The following table reconciles net income (loss) to EBITDA and Adjusted EBITDA for the periods presented.

	For the three months ended		For the six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Net income	\$ 5,918	\$ 5,398	\$ 8,244	\$ 1,441
Plus:				
Tax expense (benefit)	881	1,020	1,381	(47)
Depreciation	1,529	1,780	3,183	3,030
Amortization	1,278	1,257	2,557	2,397
Interest	2,242	2,216	4,179	3,981
EBITDA	\$ 11,848	\$ 11,671	\$ 19,544	\$ 10,802
Acquisition costs ⁽¹⁾	2,889	151	3,465	3,366
Stock based compensation expense	1,602	756	3,146	1,454
Purchase accounting adjustment to inventory	—	—	—	1,502
Non same-store revenue ⁽²⁾	(2,155)	(1,082)	(3,671)	(1,303)
Non same-store costs ⁽²⁾	4,044	2,434	7,296	2,822
Fair value adjustment of contingent note	1,460	459	780	600
Integration costs and costs of discontinued clinics ⁽³⁾	1,142	385	1,142	756
Clinic launch expenses ⁽⁴⁾	—	846	—	1,211
Non-recurring royalty settlement ⁽⁵⁾	—	440	—	440
Adjusted EBITDA	\$ 20,830	\$ 16,060	\$ 31,702	\$ 21,650

- (1) Acquisition costs relating to various acquisitions, both completed and contemplated.
- (2) Non same-store revenue and costs are from wellness centers, host partners, and regions with less than six full trailing quarters of operating results. There were 32 wellness centers, 7 regions, and one new host partner that had less than six trailing quarters of operating results for the three and six months ended June 30, 2019 23 wellness centers and 5 regions for the three and six months ended June 30, 2018.
- (3) Integration costs and costs of discontinued clinics represent costs related to integrating the acquired businesses, such as personnel costs like severance and signing bonuses, consulting work, brand realignment and SKU rationalization, and IT conversion costs, in addition to costs associated with vet services clinics that were discontinued subsequent to the acquisition of VIP.
- (4) Clinic launch expenses represent the nonrecurring costs to open new veterinary wellness centers, primarily employee costs, training, marketing, and rent prior to opening for business.
- (5) Non-recurring royalty settlement represents a settlement paid to a supplier related to a royalty agreement in place since 2013.

Financial Condition, Liquidity, and Capital Resources

Historically, our primary sources of liquidity have been cash flows from operations, borrowings, and equity contributions. As of June 30, 2019 and December 31, 2018, our cash and cash equivalents were \$36.6 million and \$66.4 million, respectively. As of June 30, 2019, we had \$5.1 million outstanding under a revolving credit facility, \$74.3 million under a term loan, \$17.5 million due under Notes Payable – VIP Acquisition, and \$1.8 million outstanding under a mortgage. Up to an additional \$10 million may be payable pursuant to the 2019 Contingent Note. The debt agreements bear interest at rates between 4.35% and 7.75%.

Our primary cash needs are for working capital. Our maintenance capital expenditures have typically been less than 1.0% of net sales, but we may make additional capital expenditures as necessary to support our growth, such as the investment in additional veterinary clinics. Our primary working capital requirements are to carry inventory and receivable levels necessary to support our increasing net sales. Fluctuations in working capital are primarily driven by the timing of new product launches and seasonal retailer demand. As of June 30, 2019 and December 31, 2018, we had working capital (current assets less current liabilities) of \$148.0 million and \$143.5 million, respectively.

We believe that our operating cash flow, cash on hand, and debt proceeds from our borrowings under our credit facility will be adequate to meet our operating, investing, and financing needs for the foreseeable future. To the extent additional funds are necessary to meet long-term liquidity needs as we continue to execute our business strategy, we anticipate that they will be obtained through the incurrence of additional indebtedness, additional equity financings or a combination of these potential sources of funds, although we can provide no assurance that these sources of funding will be available on reasonable terms.

Cash Flows

Cash used in Operating Activities

Net cash used in operating activities was \$18.1 million for the six months ended June 30, 2019 compared to cash used in operating activities of \$8.8 million for the six months ended June 30, 2018. The change in operating cash flows primarily reflects higher earnings, offset by higher non-cash items such as depreciation and amortization and increases in working capital. Working capital uses are driven by increased accounts receivable resulting from our growing net sales and higher inventory to support growing net sales. Net changes in assets and liabilities accounted for \$37.9 million in cash used in operating activities for the six months ended June 30, 2019 compared to \$17.6 million of cash used in operating activities for the six months ended June 30, 2018.

Cash used in Investing Activities

Net cash used in investing activities was \$1.7 million for the six months ended June 30, 2019, compared to \$96.7 million for the six months ended June 30, 2018. The decrease in net cash used in investing activities is a result of the VIP Acquisition that occurred in the prior year period.

Cash (used in) provided by Financing Activities

Net cash used in financing activities was \$10.1 million for the six months ended June 30, 2019 compared to \$79.4 million in net cash provided by financing activities for the six months ended June 30, 2018. The change in cash provided by financing activities to cash used by financing activities is primarily driven by the Company's new debt taken out to finance the VIP Acquisition in the prior year period.

Description of Indebtedness

A&R Credit Agreement

In connection with the VIP Acquisition, the Company amended and restated its existing revolving credit agreement (the "A&R Credit Agreement") on January 17, 2018, which was subsequently amended in August 2018. The A&R Credit Agreement provides for a secured revolving credit facility of \$75 million in the aggregate, at either LIBOR or Base (prime) interest rates plus an applicable margin. The A&R Credit Agreement matures on January 17, 2023 and contains a lockbox mechanism.

All obligations under the A&R Credit Agreement are unconditionally guaranteed by Holdco and each of its domestic wholly-owned subsidiaries and, subject to certain exceptions, each of its material current and future domestic wholly-owned subsidiaries. All obligations under the A&R Credit Agreement, and the guarantees of those obligations, are secured by substantially all of the assets of each borrower and guarantor under the A&R Credit Agreement, subject to certain exceptions.

Also in connection with the closing of the VIP Acquisition, the Company entered into a term loan credit agreement (the "Term Loan"). The Term Loan provides for a secured term loan credit facility of \$75 million in aggregate at either LIBOR or Base (prime) interest rates plus an applicable margin. The Term Loan Credit Agreement requires quarterly principal payments, with the full balance due on January 17, 2023.

As of June 30, 2019, the Company had \$5.1 million outstanding under the A&R Credit Agreement and \$74.3 million under the Term Loan Credit Agreement. The interest rate on the A&R Credit Agreement was 5.5% as a Base Rate loan,

the interest rate on the Term Loan Credit Agreement was 7.7% as a LIBOR rate loan. Additionally the Company pays between 0.375% and 0.50% as an unused facility fee, depending on the amount borrowed.

The A&R Credit Agreement and Term Loan Credit Agreement contain certain covenants and restrictions including a fixed charge coverage ratio and a minimum EBITDA target and is secured by collateral consisting of a percentage of eligible accounts receivable, inventories, and machinery and equipment. As of June 30, 2019, the Company was in compliance with these covenants. The availability of certain baskets and the ability to enter into certain transactions (including our ability to pay dividends) may also be subject to compliance with consolidated EBITDA.

Other Debt

The Company entered into a mortgage with a local bank to finance \$1.9 million of the purchase price of a commercial building in Eagle, Idaho, in July 2017. The mortgage bears interest at a fixed rate of 4.35% and utilizes a 25 year amortization schedule with a 10 year balloon payment of the balance due at that time.

In connection with the VIP Acquisition, the Company entered into a guarantee note which requires the Company to pay \$10.0 million on July 17, 2023. The note bears interest at a fixed 6.75% and requires quarterly interest payments.

Also in connection with the VIP Acquisition, the Company has entered into an additional guarantee note, generated from an EBITDA target established and met by the Company, which requires the Company to pay \$7.5 million on July 17, 2023. The note bears interest at a fixed 6.75% and requires quarterly interest payments.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We are exposed to certain market risks arising from transactions in the normal course of our business. Such risk is principally associated with interest rates. We currently do not enter into derivatives or other financial instruments for trading or speculative purposes.

Interest Rate Risk

We are exposed to changes in interest rates because the indebtedness incurred under our New Credit Agreement is variable rate debt. Interest rate changes generally do not affect the market value of our credit agreement but do affect the amount of our interest payments and, therefore, our future earnings and cash flows. As of June 30, 2019, we had variable rate debt of approximately \$79.4 million under our Revolver and Term Loan. An increase of 1% would have increased our interest expense for the six months ended June 30, 2019 by approximately \$0.4 million.

Item 4. Controls and Procedures.

Internal Control over Financing Reporting

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) that are designed to ensure that information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

Effective January 1, 2019, we adopted Accounting Standards Codification 842, *Leases* (“Topic 842”). The adoption of Topic 842 had a material impact on our Balance sheet, with no significant impact to our Condensed Consolidated Statement of Operations or Cash Flows, and as such we implemented certain changes to our lease and contract management related control activities to enhance policies and periodic review procedures to incorporate specific Topic 842 considerations.

There were no other changes in our internal control over financial reporting that occurred during our fiscal quarter ended June 30, 2019, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, such as statements about our plans, objectives, expectations, assumptions or future events. In some cases, you can identify forward-looking statements by terminology such as “anticipate,” “estimate,” “plan,” “project,” “continuing,” “ongoing,” “expect,” “believe,” “intend,” “may,” “will,” “should,” “could” and similar expressions. Examples of forward-looking statements include, without limitation:

- statements regarding our strategies, results of operations or liquidity;
- statements concerning projections, predictions, expectations, estimates or forecasts as to our business, financial and operational results and future economic performance;
- statements of management’s goals and objectives; and
- assumptions underlying statements regarding us or our business.

Forward-looking statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from any future results, performances, or achievements expressed or implied by the forward-looking statements. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by, which such performance or results will be achieved. Forward-looking statements are based on information available at the time those statements are made or management’s good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. Important factors that could cause such differences include, but are not limited to, factors discussed under the headings “Management’s Discussion and Analysis of Financial Condition and Results of Operations”; our ability to successfully grow our business through acquisitions; our dependency on a limited number of customers; our ability to implement our growth strategy effectively; disruptions in our manufacturing and distribution chains; competition from veterinarians and others in our industry; reputational damage to our brands; economic trends and spending on pets; the effectiveness of our marketing and trade promotion programs; recalls or withdrawals of our products or product liability claims; our ability to manage our manufacturing and supply chain effectively; disruptions in our manufacturing and distribution chains; our ability to introduce new products and improve existing products; our failure to protect our intellectual property; costs associated with governmental regulation; our ability to keep and retain key employees; our ability to sustain profitability; and the risks set forth under the “Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2018.

Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or operating results. The forward-looking statements speak only as of the date on which they are made, and, except as required by law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect

the occurrence of unanticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Consequently, you should not place undue reliance on forward-looking statements.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

On April 4, 2018, Med Vets, Inc. and Bay Medical Solutions Inc. (collectively “Plaintiffs”) filed suit in the United States District Court for the Northern District of California against PetIQ and VIP Petcare Holdings, Inc. for alleged unlawful merger and other antitrust violations. On April 22, 2019 the Court granted the Company’s Motion to Dismiss without further leave to amend, concluding that Plaintiffs were not able to identify any factual allegations to support their alleged claims. Plaintiffs filed a notice of appeal with 9th Circuit Court of Appeals on May 21, 2019. Appeal briefing will occur during late 2019 and early 2020.

We are from time to time subject to, and are presently involved in, litigation and other proceedings. Other than the litigation described above, we believe that there are no pending lawsuits or claims that, individually or in the aggregate, may have a material adverse effect on our business, financial condition or results of operations.

Item 1A. Risk Factors.

There have been no material changes to the risk factors disclosed in our annual report on Form 10-K for the year ended December 31, 2018.

Item 5. Other Information

Placeholder

Item 6. Exhibits.

- 2.1 [Purchase and Sale Agreement, dated May 8, 2019, by and among PetIQ, LLC, L.Perrigo Company, Perrigo Company plc and PetIQ, Inc. \(Incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K, filed May 8, 2019\)](#)
- 10.1** [Second Amendment to Amended and Restated Revolving Credit Agreement, dated March 25, 2019, by and among PetIQ, LLC, East West Bank, as a lender and as the administrative agent, the lenders party thereto and the other credit parties party thereto](#)
- 10.2 [PetIQ, Inc. Amended and Restated 2017 Omnibus Incentive Plan \(Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed May 31, 2019\)](#)
- 10.3 [First Amendment to Purchase and Sale Agreement, dated July 7, 2019, by and among PetIQ, LLC, L. Perrigo Company, Perrigo Company plc and PetIQ, Inc. \(Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed July 9, 2019\)](#)
- 10.4 [Third Amendment to Amended and Restated Revolving Credit Agreement, dated July 8, 2019, by and among PetIQ, LLC, East West Bank, as a lender and as the administrative agent, the lenders party thereto and the other credit parties party thereto \(Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed July 9, 2019\)](#)

- 10.5 [Amended and Restated Term Loan Credit Agreement, dated July 8, 2019, by and among PetIQ, LLC, the guarantors party thereto, Ares Capital Corporation, as a lender and as the administrative agent, and the other lenders party thereto \(Incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K, filed July 9, 2019\)](#)
- 10.6 [Transition Services Agreement, dated July 8, 2019, by and between PetIQ, LLC and L. Perrigo Company \(Incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K, filed July 9, 2019\)](#)
- 10.7* [Employment and Non-Competition Agreement, dated May 28, 2019, between PetIQ, LLC and Michael Smith \(Incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K, filed July 9, 2019\)](#)
- 31.1* [Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- 31.2* [Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- 32.1* [Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 32.2* [Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 101.INS* XBRL Instance Document.
- 101.SCH* XBRL Taxonomy Extension Schema Document.
- 101.CAL* XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.LAB* XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE* XBRL Taxonomy Extension Presentation Linkbase Document.
- 101.DEF* XBRL Taxonomy Extension Definition Linkbase Document.

* Management compensatory agreement

** Filed herewith

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.

PETIQ, INC.

August 8, 2019

/s/ John Newland

John Newland
Chief Financial Officer

SECOND AMENDMENT TO AMENDED AND RESTATED
CREDIT AGREEMENT

THIS SECOND AMENDMENT TO AMENDED AND RESTATED CREDIT AGREEMENT (this "Amendment"), dated as of March 25, 2019, is entered into by and among PETIQ, LLC, an Idaho limited liability company ("PetIQ"), the other Credit Parties signatory hereto (collectively with PETIQ, the "Borrowers"), the LENDERS signatory hereto, and EAST WEST BANK, a California banking corporation, as Administrative Agent for the Lenders (in such capacity, "Administrative Agent"), with reference to the following facts:

RECITALS

A. The Borrowers, the Lenders, and Administrative Agent are parties to an Amended and Restated Credit Agreement dated as of January 17, 2018, as amended by the First Amendment to Amended and Restated Credit Agreement and Joinder dated as of August 9, 2018 and as supplemented by the Consent Agreement dated as of October 17, 2018 and the Joinder No. 1 to Amended and Restated Credit Agreement dated as of December 10, 2018 (collectively, the "Credit Agreement") and certain other related Loan Documents, pursuant to which the Lenders provide the Borrowers a revolving credit facility with sub-facilities for letters of credit and swing line loans.

B. The parties hereto desire to amend the Credit Agreement: (i) to increase the limit on Cash Management Obligations from \$5,000,000 to \$10,000,000; and (ii) to remove Cash Management Obligations as a sub-line of credit under the Revolving Credit Facility, so that outstanding Cash Management Obligations no longer will reduce borrowing availability under the Revolving Credit Facility.

NOW, THEREFORE, the parties hereby agree as follows:

1. Defined Terms. All initially capitalized terms used in this Amendment (including in the recitals hereto) without definition shall have the respective meanings set forth for such terms in the Credit Agreement.

2. Increase in Permitted Cash Management Obligations. Section 1.01 of the Credit Agreement is hereby amended by amending and restating the definition of "Cash Management Obligations" so that it reads in full as follows (changes to the text are indicated with a ~~strike through~~ or in ***bold, italicized and underscored*** type):

"Cash Management Obligations" means, as of any date of determination, the aggregate outstanding obligations of Borrowers to Cash Management Banks pursuant to Cash Management Agreements, provided that Cash Management Obligations may not exceed ~~\$5,000,000~~ **\$10,000,000** at any time.

3. Removal of Cash Management Obligations as a Sub-Line of the Revolving Credit Facility. Section 1.01 of the Credit Agreement is hereby further amended by amending and restating the definition of "Total Revolving Credit Outstandings" so that it reads in full as

follows (changes to text are indicated with a ~~strike through~~ or in **bold, italicized and underscored** type):

“Total Revolving Credit Outstandings” means, as of the date of determination, the sum of (a) the aggregate Outstanding Amount of all Revolving Credit Loans, (b) the aggregate Outstanding Amount of all L/C Obligations, **and** ~~(iii)~~ **(c)** the aggregate Outstanding Amount of all Swingline Loans, **and** ~~(iv)~~ the aggregate Outstanding Amount of all Cash Management Obligations.

4. Reduction of Priority of Cash Management Obligations and Secured Hedge Obligations. Section 8.03 of the Credit Agreement is hereby amended and restated to read in full as follows (changes to text are indicated with a ~~strike through~~ or in **bold, italicized and underscored** type):

“**8.03 Application of Funds**. In the event that, following the occurrence and during the continuance of any Event of Default, the Administrative Agent or any Lender receives any monies in connection with the enforcement of any of the Loan Documents, or otherwise with respect to the realization upon any of the Collateral, the Administrative Agent may apply (and shall apply at (a) the request of the Required Lenders or (b) following the exercise of remedies pursuant to Section 8.02, including without limitation, pursuant to the proviso thereof) such monies as follows (and each Lender shall comply with the instructions of the Administrative Agent in the case of any such monies received by such Lender):

i. First, to payment of outstanding Pro Rata Protective Advances and Out-of-Formula Advances ratably among the holders thereof in proportion to the respective amounts described in this clause First and if the Revolving Credit Lenders have declined to participate in Protective Advances pursuant to Section 2.17(a), to payment of outstanding Protective Advances not to exceed 10% of the Borrowing Base as of the date of the making of such Protective Advances funded by the Administrative Agent;

ii. Second, to payment of that portion of the Obligations owing to the Administrative Agent constituting (a) indemnities and expenses due and payable under this Agreement and the other Loan Documents (including reasonable and documented fees, charges and disbursements of counsel to the Administrative Agent), and (b) the fees due and payable under the Fee Letter;

iii. Third, to the payment of that portion of the Obligations constituting ~~(i)~~ **(a)** indemnities and expenses (including reasonable and documented fees, charges and disbursements of counsel to the Lenders and amounts payable under Article III) due and payable to the Lenders under this Agreement and the other Loan Documents, ~~(ii)~~ **(b)** accrued and unpaid interest and fees (including Unused Facility Fees, Early Revolving Credit Facility Termination Fees and Letter of Credit Fees) due and payable to the Lenders, **and** ~~(iii)~~ **(c)** unpaid principal of the Revolving Credit Loans, the L/C Borrowings and the Swingline Loans, ratably among the holders thereof, ~~(iv)~~ Secured Cash Management Obligations then owing under Secured Cash Management Agreements, and ~~(v)~~ Secured Hedge Obligations then owing under Secured Hedge Agreements;

iv. ~~Fourth~~, to the payment of that portion of the Obligations constituting (a) Secured Cash Management Obligations then owing under Secured Cash Management Agreements, and (b) Secured Hedge Obligations then owing under Secured Hedge Agreements;

~~iv. v.~~ ~~Fourth~~, Fifth, if the Revolving Credit Lenders have declined to participate in Protective Advances pursuant to Section 2.17, to payment of outstanding Protective Advances funded by the Administrative Agent remaining outstanding after the application of clause First above;

~~v. vi.~~ ~~Fifth~~, Sixth, to the Administrative Agent for the account of the L/C Issuer, to Cash Collateralize that portion of L/C Obligations comprised of the aggregate undrawn amount of Letters of Credit to the extent not otherwise Cash Collateralized by the Borrowers pursuant to Sections 2.03 and 2.21;

~~vi. vii.~~ ~~Sixth~~, Seventh, the payment in full of all other Obligations due and payable ratably among the holders thereof; and

~~vii. viii.~~ ~~Seventh~~, Eighth, the balance, if any, after all of the Obligations have been indefeasible paid in full, to the Borrowers or as otherwise required by Law.

All payments applied to the Loans pursuant to this Section 8.03 shall be applied to the Loans owing to the Lenders in accordance with their respective Applicable Percentages.”

5. Condition Precedent. The effectiveness of this Amendment shall be subject to Administrative Agent’s receipt of this Amendment, duly executed by the Borrowers, the Required Lenders, and Administrative Agent.

6. General Amendment Provisions.

A. The Credit Agreement, as amended hereby, shall be and remain in full force and effect in accordance with its terms, and Borrowers hereby ratify and confirm the Credit Agreement in all respects. Except as expressly set forth herein, the execution, delivery, and performance of this Amendment shall not operate as a waiver of, an amendment to, or a consent to a deviation from, any right, power, or remedy of Administrative Agent or the Lender under the Credit Agreement or any other Loan Document, as in effect prior to the date hereof.

B. The Borrowers represent and warrant to Administrative Agent and the Lenders that the representations and warranties contained in the Credit Agreement are true and correct in all material respects as of the date of this Amendment (except for representations and warranties that expressly relate to an earlier date, which are true and correct in all material respects as of such earlier date) and that no Event of Default has occurred and is continuing.

C. This Amendment constitutes the entire agreement of the parties in connection with the subject matter hereof and cannot be changed or terminated orally. All prior agreements, understandings, representations, warranties and negotiations regarding the subject matter hereof, if any, are merged into this Amendment.

D. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one instrument. In the event that any signature is delivered by facsimile transmission or by e-mail delivery of a “.pdf” format data file, such signature shall create a valid and binding obligation of the party executing this Amendment (or on whose behalf such signature is executed) with the same force and effect as if such facsimile or “.pdf” signature page were an original hereof.

E. This Amendment shall be governed by, and construed and enforced in accordance with, the internal laws (as opposed to the conflicts of law principles) of the State of New York.

[Remainder of page intentionally left blank; signature pages follow]

IN WITNESS WHEREOF, the undersigned have executed this Amendment by their respective duly authorized officers as of the date first above written.

The Borrowers:

PETIQ, LLC,

an Idaho limited liability company

By /s/ John Newland

Name: John Newland

Title: CFO

TRUE SCIENCE HOLDINGS, LLC,

a Florida limited liability company

By /s/ John Newland

Name: John Newland

Title: CFO

TRURX LLC,

an Idaho limited liability company

By /s/ John Newland

Name: John Newland

Title: CFO

TRU PRODIGY, LLC,

a Texas limited liability company

By /s/ John Newland

Name: John Newland

Title: CFO

Second Amendment to Amended and Restated Credit Agreement

COMMUNITY VETERINARY CLINICS LLC,
a Delaware limited liability company

By /s/ John Newland
Name: John Newland
Title: CFO

PET SERVICES OPERATING, LLC,
a Delaware limited liability company

By /s/ John Newland
Name: John Newland
Title: CFO

PAWPLUS MANAGEMENT, LLC,
a Delaware limited liability company

By /s/ John Newland
Name: John Newland
Title: CFO

VIP PETCARE, LLC,
a Delaware limited liability company

By /s/ John Newland
Name: John Newland
Title: CFO

COMMUNITY CLINICS, INC.,
a California corporation

By /s/ John Newland
Name: John Newland
Title: CFO

Second Amendment to Amended and Restated Credit Agreement

HBH ENTERPRISES LLC,
a Utah limited liability company

By: PETIQ, LLC
Its: Sole Member

By /s/ John Newland
Name: John Newland
Title: CFO

Second Amendment to Amended and Restated Credit Agreement

The Agent, L/C Issuer and Swingline Lender:

EAST WEST BANK,

as Administrative Agent, LC/Issuer and Swingline Lender

By: /s/ David Lehner

David A. Lehner

Senior Vice President

Second Amendment to Amended and Restated Credit Agreement

The Syndication Agent:

KEYBANK NATIONAL ASSOCIATION,
as Syndication Agent

By /s/ Anthony Alexander

Name: Anthony Alexander

Title: Vice President

Second Amendment to Amended and Restated Credit Agreement

The Lenders:

EAST WEST BANK,
as a Lender

By: /s/ David Lehner
David A. Lehner
Senior Vice President

Second Amendment to Amended and Restated Credit Agreement

COMERICA BANK,
as a Lender

By /s/ Daniel Kellow

Name: Daniel Kellow

Title: Portfolio Manager

Second Amendment to Amended and Restated Credit Agreement

KEYBANK NATIONAL ASSOCIATION,
as a Lender

By /s/ Anthony Alexander
Name: Anthony Alexander
Title: Vice President

Second Amendment to Amended and Restated Credit Agreement

**CERTIFICATION PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, McCord Christensen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of PetIQ, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2019

/s/ McCord Christensen
McCord Christensen
Chief Executive Officer

**CERTIFICATION PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, John Newland, certify that:

1. I have reviewed this quarterly report on Form 10-Q of PetIQ, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2019

/s/ John Newland
John Newland
Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of PetIQ, Inc. (the "Company") for the period ended June 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, McCord Christensen, Chief Executive Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ McCord Christensen

McCord Christensen
Chief Executive Officer

Date: August 8, 2019

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of PetIQ, Inc. (the "Company") for the period ended June 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John Newland, Chief Financial Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ John Newland

John Newland
Chief Financial Officer

Date: August 8, 2019
