FORM S-1 · REGISTRATION STATEMENT

# PETS COM INC

IPO priced 2000-02-10 · $11.00 a share · IPET




From S1 Directory · www.s1directory.com/s1/pets-com-inc/ · Source: https://www.sec.gov/Archives/edgar/data/1100683/000089161899005609/0000891618-99-005609.txt

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON DECEMBER 9, 1999

REGISTRATION NO. 333-XXXXX

SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

FORM S-1 REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

PETS.COM, INC. (EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

| DELAWARE | 5999 | 95-4730753 |
|---|---|---|
| (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION) | (PRIMARY STANDARD INDUSTRIAL CLASSIFICATION CODE NUMBER) | (I.R.S. EMPLOYER IDENTIFICATION NUMBER) |

435 BRANNAN STREET SUITE 100 SAN FRANCISCO, CA 94107 (415) 222-9999 (ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES) JULIA L. WAINWRIGHT CHIEF EXECUTIVE OFFICER PETS.COM, INC. 435 BRANNAN STREET SUITE 100 SAN FRANCISCO, CA 94107 (415) 222-9999 (NAME, ADDRESS INCLUDING ZIP CODE, AND TELEPHONE NUMBER INCLUDING AREA CODE, OF AGENT FOR SERVICE)

COPIES TO:

JOHN V. BAUTISTA, ESQ.
FRANCES JOHNSTON, ESQ.
JOHN DUGAN, ESQ.
VENTURE LAW GROUP
A PROFESSIONAL CORPORATION
2800 SAND HILL ROAD
MENLO PARK, CA 94025
(650) 854-4488

KEVIN P. KENNEDY, ESQ.
SHEARMAN & STERLING
1550 EL CAMINO REAL
MENLO PARK, CA 94025
(650) 330-2200

APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC: AS SOON AS PRACTICABLE AFTER THE EFFECTIVE DATE OF THIS REGISTRATION STATEMENT.

IF ANY OF THE SECURITIES BEING REGISTERED ON THIS FORM ARE TO BE OFFERED ON A DELAYED OR CONTINUOUS BASIS PURSUANT TO RULE 415 UNDER THE SECURITIES ACT OF 1933, CHECK THE FOLLOWING BOX. [ ] IF THIS FORM IS FILED TO REGISTER ADDITIONAL SECURITIES FOR AN OFFERING PURSUANT TO RULE 462(B) UNDER THE SECURITIES ACT, PLEASE CHECK THE FOLLOWING BOX AND LIST THE SECURITIES ACT REGISTRATION STATEMENT NUMBER OF THE EARLIER EFFECTIVE REGISTRATION STATEMENT FOR THE SAME OFFERING. [ ] ______ IF THIS FORM IS A POST-EFFECTIVE AMENDMENT FILED PURSUANT TO RULE 462(C) UNDER THE SECURITIES ACT, CHECK THE FOLLOWING BOX AND LIST THE SECURITIES ACT REGISTRATION STATEMENT NUMBER OF THE EARLIER EFFECTIVE REGISTRATION STATEMENT FOR THE SAME OFFERING. [ ] ______ IF THIS FORM IS A POST-EFFECTIVE AMENDMENT FILED PURSUANT TO RULE 462(D) UNDER THE SECURITIES ACT, CHECK THE FOLLOWING BOX AND LIST THE SECURITIES ACT REGISTRATION STATEMENT NUMBER OF THE EARLIER EFFECTIVE REGISTRATION STATEMENT FOR THE SAME OFFERING. [ ] ______ IF DELIVERY OF THE PROSPECTUS IS EXPECTED TO BE MADE PURSUANT TO RULE 434, PLEASE CHECK THE FOLLOWING BOX. [ ]

CALCULATION OF REGISTRATION FEE

| TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED | PROPOSED MAXIMUM AGGREGATE OFFERING PRICE(1) | AMOUNT OF REGISTRATION FEE |
|---|---|---|
| Common Stock, par value $0.001(2)..... | $100,000,000 | $26,400 |

(1) ESTIMATED SOLELY FOR THE PURPOSE OF COMPUTING THE AMOUNT OF THE REGISTRATION FEE PURSUANT TO RULE 457(O) UNDER THE SECURITIES ACT.

(2) THE AMOUNT OF SHARES REGISTERED ALSO INCLUDES ANY SHARES INITIALLY ORDERED OR SOLD OUTSIDE THE UNITED STATES THAT ARE THEREAFTER SOLD OR RESOLD IN THE UNITED STATES. OFFERS AND SALES OF SHARES OUTSIDE THE UNITED STATES ARE BEING MADE PURSUANT TO THE EXEMPTION AFFORDED BY RULE 901 OF REGULATION S AND THIS REGISTRATION STATEMENT SHALL NOT BE DEEMED EFFECTIVE WITH RESPECT TO SUCH OFFERS AND SALES. THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY

ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THIS REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

THE INFORMATION IN THIS PRELIMINARY PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. WE MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PRELIMINARY PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IT IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

SUBJECT TO COMPLETION

PRELIMINARY PROSPECTUS DATED DECEMBER 9, 1999

PROSPECTUS

SHARES

LOGO

COMMON STOCK

This is Pets.com's initial public offering of common stock. The U.S. underwriters are offering shares in the U.S. and Canada and the international managers are offering shares outside the U.S. and Canada.

We expect the public offering price to be between $ and $ per share. After pricing this offering, we expect that the common stock will be quoted on the Nasdaq National Market under the symbol "IPET."

INVESTING IN THE COMMON STOCK INVOLVES MATERIAL RISKS WHICH ARE DESCRIBED IN THE "RISK FACTORS" SECTION BEGINNING ON PAGE 5 OF THIS PROSPECTUS.

| | PER SHARE | TOTAL |
|---|---|---|
| Public offering price | $ | $ |
| Underwriting discount | $ | $ |
| Proceeds, before expenses, to Pets.com, Inc. | $ | $ |

THE U.S. UNDERWRITERS MAY ALSO PURCHASE UP TO AN ADDITIONAL SHARES FROM PETS.COM AT THE PUBLIC OFFERING PRICE, LESS THE UNDERWRITING DISCOUNT, WITHIN 30 DAYS FROM THE DATE OF THIS PROSPECTUS TO COVER OVER-ALLOTMENTS. THE INTERNATIONAL MANAGERS MAY SIMILARLY PURCHASE UP TO AN ADDITIONAL SHARES FROM PETS.COM.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THE SHARES OF COMMON STOCK WILL BE READY FOR DELIVERY IN NEW YORK, NEW YORK ON OR ABOUT , 2000.

MERRILL LYNCH & CO. BEAR, STEARNS & CO. INC. THOMAS WEISEL PARTNERS LLC WARBURG DILLON READ LLC THE DATE OF THIS PROSPECTUS IS , 2000.

# *Table of Contents*

## *Page*


Summary..... 1
Risk Factors..... 5
Forward-Looking Statements..... 18

Use of Proceeds..... 18
Dividend Policy..... 18
Capitalization..... 19
Dilution..... 20
Selected Financial Information..... 21
Management's Discussion and Analysis of Financial Condition and Results of Operations..... 22
Business..... 27
Management..... 43
Related Party Transactions..... 55
Principal and Selling Stockholders..... 58
Description of Capital Stock..... 60
Shares Eligible for Future Sale..... 62
Underwriting..... 64
Legal Matters..... 68
Experts..... 68
Additional Information..... 68
Index to Financial Statements..... F-1

You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate as of the date on the front cover of this prospectus only. Our business, financial condition, results of operation and prospects may have changed since that date.

Pets.com(TM), the Pets.com logo, Because Pets Can't Drive(TM), Keep It Comin'(TM), More Products Than A Superstore Delivers(TM), People Helping Animals, Animals Helping People(TM), and Pets.commitment(TM) are trademarks of Pets.com and Pets.com has the right to use Pets.complete(TM). All other brand names or trademarks appearing in this prospectus are the property of their respective holders. Use or display by Pets.com of other parties' trademarks, trade dress or products is not intended to and does not imply a relationship with, or endorsement or sponsorship of, Pets.com by the trademark or trade dress owners.

# *Prospectus Summary*

You should read the following summary together with the more detailed information regarding our company and financial statements appearing elsewhere in this prospectus.

# *Pets.com, Inc.*

We are a leading online retailer of pet products, integrating product sales with expert information on pets and their care. We are committed to serving pets and their owners with the best care possible through a broad product selection, expert information and superior service. We seek to address the entire pet products market, transcending the limited product selection of superstores, specialty stores and grocery stores. Our broad selection of approximately 12,000 SKUs is integrated with extensive pet-related information and resources designed to help consumers make informed purchasing decisions.

We designed our Web store to provide our customers with a convenient, one-stop shopping experience that is organized to reflect how consumers think about shopping for their pets. Our Web store addresses the needs of many of the most popular pets, including dogs, cats, birds, fish, reptiles, ferrets, and other small pets. We provide quality customer service through our in-house distribution, fulfillment, customer service, and technology operations. Furthermore, we encourage participation in the pet community both through our Web store and through Pets.commitment, our charitable foundation that supports the role that pets and people play in each others' lives.

The pet products industry in the United States is a large and growing market characterized by a loyal and emotion-driven customer base. According to the Pet Industry Joint Advisory Council, U.S. consumer spending on pet products and services grew at an annual rate of approximately 9% per year between 1993 and 1997, totaling approximately $23 billion at the end of 1997. Today, more than 60% of U.S. households own a pet and 40% of those households own more than one pet, according to a recent American Pet Products Manufacturers Association study. The pet products market has traditionally been served by a combination of traditional store-based retailers, including superstores, independent specialty stores and grocery stores. This market is highly fragmented, and generally requires consumers to expend considerable time and effort shopping for pet products in multiple stores to meet all their needs.

We provide consumers with one-stop shopping for their pet care needs. We seek to attract and retain consumers by emphasizing the following key attributes:

Extensive Product Selection. With only one distribution center at this time, our SKU count is currently equivalent to the number available at the largest pet superstores, and by the middle of 2000 we expect our SKU count will increase to approximately two times the SKUs available at these stores.

Expert Information and Professional Resources. We provide consumers extensive pet and pet care information integrated throughout our Web store through our in-house staff of pet experts and strategic relationships.

Superior Shopping Experience. We believe that we provide an intuitive, easy-to-use Web store, categorized and organized the way people think about shopping for their pets. We also offer our customers a highly streamlined checkout experience and direct delivery to their doors.

Quality Customer Service. We have invested significant resources to create our own fulfillment, distribution, and both online and in-person help service functions to enable us to better control all aspects of the customers' shopping experience.

Community. Visitors to our Web store can participate online in 60 different pet discussion forums, sign up for our online newsletter and get information on our Pets.commitment charitable foundation.

Our objective is to become one of the world's leading retailers of pet products. Key elements of our strategy include:

- Building enduring brand equity through an advertising strategy which includes our Pets.com sock puppet brand icon, relationships with select online companies, and support for national events and pet-related local market activities;

- Offering the broadest possible pet product selection available to our customers at competitive prices;

- Establishing our private label brands for pet products marketed under the Pets.complete and Pets.com brand names;

- Providing increasingly comprehensive and relevant content in conjunction with a range of consumer and veterinary care partners;

- Delivering superior customer service and promoting repeat purchases through investments in people, technology and distribution facilities;

- Continuing to maintain and expand our relationship with Amazon.com which is currently our largest stockholder; and - Expanding internationally in order to capitalize on the global market.

## *Other Information*

Unless otherwise noted, this prospectus assumes:

- the automatic conversion of our outstanding convertible preferred stock into common stock on a one-for-one basis upon the closing of this offering;

- our reincorporation in Delaware and the filing of our amended and restated certificate of incorporation authorizing 150,000,000 shares of common stock and a class of 5,000,000 shares of undesignated preferred stock upon the closing of the offering; and - no exercise by the underwriters of their options to purchase additional shares of our common stock in the offering.

Our net sales were $0.6 million for the period from February 1999 (inception) through September 30, 1999. Our net losses were $19.4 million for the same period.

We were formed in February 1999 and reincorporated in Delaware in 2000. Our principal executive offices are located at 435 Brannan Street, Suite 100, San Francisco, California 94107. Our telephone number is (415) 222-9999. Our Web store address is www.pets.com. Information contained in our Web store does not constitute part of this prospectus.

## *The Offerings*

Shares offered by Pets.com U.S. offering..... shares International offering..... shares Total..... shares Shares outstanding after the offering..... shares Use of proceeds..... We estimate that our net proceeds from this offering without exercise of the over-allotment options will be approximately $79.9 million. We intend to use these net proceeds for general corporate purposes, including expansion of our marketing and brand building efforts, expansion and building of distribution centers, and working capital. See "Use of Proceeds."

Risk factors..... See "Risk Factors" and other information included in this prospectus for a discussion of factors you should carefully consider before deciding to invest in shares of the common stock.

Proposed Nasdaq National Market symbol..... "IPET" In addition, the information above excludes, as of December 9, 1999, 1,335,250 shares issuable upon exercise of options granted under our stock plans, and 2,500,000 shares available for grant under our stock plans. This number assumes that the underwriters' over-allotment option is not exercised. If the over-allotment options are exercised in full, we will issue and sell an additional shares.

# *Summary Financial Data (In Thousands)*

The following table sets forth a summary of our statement of operations data for the periods presented. The pro forma net loss per share for the period from February 17, 1999 (inception) through September 30, 1999 reflects the conversion of our convertible preferred stock upon completion of this offering.

| | QUARTER ENDED JUNE 30, 1999 | QUARTER ENDED SEPTEMBER 30, 1999 | PERIOD FROM FEBRUARY 17, 1999 (INCEPTION) THROUGH SEPTEMBER 30, 1999 |
|---|---|---|---|
| STATEMENT OF OPERATIONS DATA: | | | |
| Net sales..... | $ 39 | $ 568 | $ 619 |
| Gross margin..... | (37) | (1,198) | (1,223) |
| Total operating expenses..... | 3,584 | 15,231 | 18,832 |
| Operating loss..... | (3,621) | (16,429) | (20,055) |
| Net loss..... | $ (3,498) | $ (15,852) | $ (19,355) |
| Basic and diluted net loss per share..... | $ (1.93) | $ (8.75) | $ (10.84) |
| Weighted average shares outstanding used to compute basic and diluted net loss per share... | 1,811,837 | 1,811,837 | 1,786,156 |
| Pro forma basic and diluted net loss per share... | | | $ (1.24) |
| Weighted average shares outstanding used to compute pro forma basic and diluted net loss per share..... | | | 15,636,001 |

The following data sets forth a summary of our balance sheet data as of September 30, 1999 - On an actual basis;

- On a pro forma basis to give effect to the automatic conversion of all of the outstanding shares of our convertible preferred stock into shares of common stock upon the closing of this offering; and - On a pro forma as adjusted basis to reflect the automatic conversion of all of the outstanding shares of our convertible preferred stock and our receipt of the estimated net proceeds from the sale of shares of common stock in this offering at an estimated price of $ per share.

SEPTEMBER 30, 1999 PRO FORMA ACTUAL PRO FORMA AS ADJUSTED

| | | | |
|---|---|---|---|
| BALANCE SHEET DATA: | | | |
| Cash and cash equivalents..... | $36,231 | $36,231 | $116,101 |
| Working capital..... | 34,913 | 34,913 | 114,783 |
| Total assets..... | 48,399 | 48,399 | 128,269 |
| Convertible preferred stock and related paid-in capital..... | 60,382 | -- | -- |
| Total stockholders' equity..... | 42,584 | 42,584 | 122,454 |

# *Risk Factors*

You should carefully consider the following risks before making an investment in our company. You should also refer to the other information set forth in this prospectus, including the discussions set forth in "Special Note Regarding Forward-Looking Statements," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business," as well as our financial statements and the related notes. Our business, financial condition, or results of operations could be harmed as a result of any of the following risks. In such case, the trading of our common stock could decline, and you could lose all or part of your investment.

# *Risks Related to Our Business*

WE ONLY BEGAN SELLING OUR PRODUCTS IN FEBRUARY 1999 AND WE OPERATE IN A NEW AND RAPIDLY EVOLVING MARKET, WHICH MAKES IT DIFFICULT FOR INVESTORS TO DETERMINE WHETHER WE WILL ACCOMPLISH OUR OBJECTIVES Because we were formed in February 1999 and we have yet to achieve meaningful revenues, we have a limited operating history on which investors and securities analysts can base an evaluation of our business and prospects. We have limited insight into trends that may emerge and affect our business. Accordingly, you must consider the risks and difficulties we face as an early stage company with limited operating history in a new and rapidly evolving market. We cannot be certain that our business strategy will be successful.

CONSUMERS OF PET PRODUCTS MAY NOT CHOOSE TO SHOP IN OUR WEB STORE AND PURCHASE OUR PRODUCTS, WHICH WOULD REDUCE OUR REVENUES AND PREVENT US FROM BECOMING PROFITABLE We may not be able to attract a large number of potential customers who shop in traditional retail stores to shop in our Web store. Furthermore, we may incur significantly higher and more sustained advertising and promotional expenditures than we currently anticipate to attract online shoppers to our Web store and to convert those shoppers to purchasing customers. As a result, we may not be able to achieve profitability, and even if we are successful at attracting online customers, we expect it will take several years to build a critical mass of these customers. Specific factors that could prevent widespread customer acceptance of our online solution include:

- Shipping charges, which do not apply to shopping at traditional retail stores;

- Delivery time associated with Internet orders, as compared to the immediate receipt of products at a physical store;

- Pricing that does not meet customer expectations of "finding the lowest price on the Internet;"

- Customer concerns about buying products without first seeing them in person or physically handling them;

- Lack of consumer awareness of our Web store;

- Differentiating our Web store from those of our competitors;

- Customer concerns about the security of online transactions and the privacy of their personal information;

- Product damage from shipping, delayed shipments, or shipments of wrong or expired products, resulting in a failure to establish customers' trust in buying pet store items online; and - Difficulties in returning or exchanging items purchased in our Web store.

WE HAVE A HISTORY OF LOSSES AND WE EXPECT SIGNIFICANT INCREASES IN OUR COSTS AND EXPENSES TO RESULT IN CONTINUING LOSSES FOR AT LEAST THE NEXT FOUR YEARS We incurred net losses of $15.9 million for the three-month period ended September 30, 1999 and cumulative losses of $19.4 million from our inception through September 30, 1999. We have not achieved profitability. We only began selling products in February 1999 and have yet to achieve meaningful revenue, and cannot be certain that we will obtain enough customer traffic or a high enough volume of purchases to generate sufficient revenues and achieve profitability. We believe that we will continue to incur operating and net losses for at least the next four years, and possibly longer, and that the rate at which we will incur such losses will increase significantly from current levels. We intend to increase our costs and expenses substantially as we:

- Increase our sales and marketing activities, such as increasing advertising expenses and entering into strategic marketing agreements with third parties;

- Open additional distribution centers and expand our existing distribution center;

- Provide our customers with shipping below our actual costs to attract customers;

- Increase our general and administrative functions to support our growing operations;

- Expand our customer support organization to better serve customer needs; and - Develop or license from third parties enhanced technologies and features to improve our Web store.

Because we will spend these amounts before we receive any incremental revenues from these efforts, our losses will be greater than the losses we would incur if we developed our business more slowly. In addition, we may find that these efforts are more expensive than we currently anticipate or that these efforts may not result in proportionate increases in our revenues, which would further increase our losses. We may also engage in promotional efforts such as coupons or discounts that would reduce our revenues.

WE MAY NOT SUCCEED IN ESTABLISHING THE PETS.COM BRAND, WHICH WOULD ADVERSELY AFFECT CUSTOMER ACCEPTANCE AND OUR REVENUES Due to the early stage and competitive nature of the online market for pet products, information and services, if we do not establish our brand quickly, we may lose the opportunity to build a critical mass of customers. Promoting and positioning our brand will depend largely on the success of our marketing efforts and our ability to provide consistent, high quality customer experiences. To promote our brand, we will incur substantial expense in our advertising efforts on television, radio, magazines and other forms of traditional media, along with advertising on Web sites that we believe our customers are likely to visit. We will also incur substantial expense in our efforts to enter into strategic alliances with, including

making investments in, online and more traditional companies that we believe will promote our brand and drive customers to our Web store. To provide a high quality customer experience, we will also need to spend money to attract and train customer service personnel. We also will incur substantial expenses to develop content to help build our brand and attract customers to our Web store. If these brand promotion activities do not yield increased revenues, we will incur additional losses.

Beginning in the first half of 2000, we intend to introduce a line of private label pet products. We may not achieve consumer acceptance of these products. Further, we may be forced to incur higher expenses in order to produce or market our private label product lines, which could negatively affect our financial condition or operating results.

INCREASING OUR PRODUCT DISTRIBUTION CAPACITY IS AN IMPORTANT PART OF OUR BUSINESS STRATEGY AND WILL REQUIRE SIGNIFICANT INVESTMENTS IN CASH AND MANAGEMENT RESOURCES. IF WE DO NOT SUCCESSFULLY BUILD ADDITIONAL DISTRIBUTION CENTERS, WE WILL FACE DIFFICULTIES IN INCREASING OUR REVENUES AND WE MAY LOSE CUSTOMERS TO OUR COMPETITORS We currently have one distribution center in Union City, California which has a satellite operation in Hayward, California. We expect to begin operating a second distribution center in the first half of 2000, and a third distribution center within twenty-four months thereafter. Our success depends on our ability to build additional distribution centers to accommodate increases in customer demand, reduce our shipping costs, reduce shipping times to customers, provide for a large product selection and increase our gross margins. If we do not successfully build additional distribution centers in time to accommodate increases in customer demand, we may not be able to increase our revenues and we may lose customers to our competitors.

Opening additional distribution centers will require significant capital investments in facilities and equipment, will require us to hire and train a significant number of new employees, and could divert management attention from other issues. We expect to invest from $7 million to $9 million in facilities and equipment in connection with opening an additional distribution center during the first half of 2000. For additional information relating to the risks we may face in obtaining additional financing, see "We may need to raise additional funds and these funds may not be available to us when we need them. If we cannot raise additional funds when we need them, our business could fail."

SINCE WE CURRENTLY OPERATE ONLY ONE DISTRIBUTION CENTER LOCATED IN THE SAN FRANCISCO BAY AREA, WE ARE SUSCEPTIBLE TO THE RISK OF DAMAGE TO OUR DISTRIBUTION CENTER Since we currently only operate one distribution center out of which we ship products to nearly all of our customers, we are susceptible to power and equipment failures, disruptions in our order fulfillment and delivery systems, and fires, floods and other disasters. Furthermore, since our distribution center is located in the San Francisco Bay Area, which is an earthquake-sensitive area, we are particularly susceptible to the risk of damage to, or total destruction of, our distribution center and the surrounding transportation infrastructure caused by earthquakes. We cannot assure you that we are adequately insured to cover the total amount of any losses caused by

any of the above events. In addition, we are not insured against any losses due to interruptions in our business due to damage to or destruction of our distribution center caused by earthquakes or to major transportation infrastructure disruptions or other events that do not occur on our premises.

WE HAVE ONLY BEEN SELLING PRODUCTS FOR TWO FULL QUARTERS. WE EXPECT OUR QUARTERLY FINANCIAL RESULTS TO FLUCTUATE AND OUR EARLY STAGE OF DEVELOPMENT LIMITS OUR ABILITY TO PREDICT REVENUES AND EXPENSES PRECISELY We have only been selling products for two full quarters and, as a result, we have insufficient financial data on which to forecast our revenues and operating expenses. In addition, we have insufficient results for investors and securities analysts to use in order to identify historical trends or even to make quarter to quarter comparisons of our operating results. To the extent our revenues and operating results fall below the expectations of investors and securities analysts, the trading price of our common stock may fall significantly. We expect that our revenues and operating results will vary significantly from quarter to quarter due to a number of factors, including:

- Consumer traffic to our Web store may fluctuate depending on the effectiveness of our sales and marketing campaign, the timing and level of promotion support we receive from Amazon.com and the effectiveness of content on our Web store and other factors;

- The level of repeat purchases by customers, average order size and mix of products sold may fluctuate as a result of the experience consumers have on our Web store, the availability of products we have for sale, seasonal factors and other factors;

- Our revenues may decline as a result of promotional offers made by our competitors, the introduction of products or services offered by our competitors, or the introduction of new competitors into our market;

- We may experience consumer dissatisfaction with our Web store as we add or change features, or as a result of technical difficulties on our Web store that do not permit a consumer to access our Web store or to complete a shopping session;

- Our expenses will also fluctuate depending on the timing and nature of expansion of our distribution center; and our ability to achieve efficiencies and lower shipping costs as a result of this expansion;

- Changes in government regulation of the Internet, particularly the imposition of sales tax for online transactions, may discourage online shopping and result in decreased revenues; and - We may incur costs related to potential acquisitions of technology or businesses.

Our operating expenses are largely based on anticipated revenue trends and a high percentage of our expenses are fixed in the short term. As a result, a delay in generating or recognizing revenue for any reason could result in substantial additional operating losses. The volume and timing of orders of pet products on our Web store are difficult to predict because the online market for such products is in its infancy. Due to the limited operating history of our Web store, we do not have a material amount of 7 repeat business from regular customers. Because our Web store is designed to encourage repeat business and we do not yet have sufficient historical data on how successful this strategy will be, we cannot currently forecast revenue from regular customers or overall anticipated revenue trends.

Furthermore, as a result of our limited operating history, it is difficult to predict the volatility associated with the nature and timing of special promotional offers, such as reducing the price on selected products, providing redeemable coupons to customers, or offering shipping below our actual costs, and our advertising efforts. For example, our revenues may decrease significantly after a promotional offer has expired or prior to an expected offer. In addition, our advertising expenses may be disproportionately higher than our anticipated revenues from these advertising efforts.

WE WILL NEED TO RAISE ADDITIONAL FUNDS AND THESE FUNDS MAY NOT BE AVAILABLE TO US WHEN WE NEED THEM. IF WE CANNOT RAISE ADDITIONAL FUNDS WHEN WE NEED THEM, OUR BUSINESS COULD FAIL Based on our current projections, we will need to raise funds over time through the issuance of equity, equity-related or debt securities or through obtaining credit from financial institutions in addition to the funds we are raising in this offering. We cannot be certain that additional funds will be available to us on favorable terms when required, or at all. If this additional financing is not available to us we may need to dramatically change our business plan, sell or merge our business, or face bankruptcy. In addition, our issuance of equity or equity-related securities will dilute the ownership interest of existing stockholders and our issuance of debt securities could increase the risk or perceived risk of our company. Any of these actions could cause our stock price to fall.

A PORTION OF OUR REVENUES MAY BE SEASONAL, WHICH COULD CAUSE OUR QUARTERLY FINANCIAL RESULTS TO FLUCTUATE. THE FACT THAT WE HAVE NOT YET GENERATED REVENUE FOR A FULL YEAR AND THE RAPID GROWTH IN OUR REVENUES SINCE OUR INCEPTION MAKE IT IMPOSSIBLE TO ASSESS THE IMPACT OF THESE FACTORS A portion of our revenues may be seasonal in nature, associated with the sale of gift products for pets during the holiday season, the sale of outdoor and activity-related pet products during the Spring season and the sale of flea and tick products for pets during the Summer season. In addition, consumer fads and other changes in consumer trends may cause shifts in purchasing patterns, resulting in significant fluctuations in our operating results from one quarter to the next. The fact that we have not yet generated revenue for a full year and the rapid growth in our revenues since our inception make it impossible to assess the impact of these factors.

WE DEPEND ON OUR ADVERTISING AGREEMENT WITH AMAZON.COM TO ATTRACT CUSTOMERS TO OUR WEB STORE AND BUILD OUR BRAND. IN THE EVENT OUR ADVERTISING AGREEMENT WITH AMAZON.COM WERE TO TERMINATE, WE COULD FACE SIGNIFICANTLY HIGHER COSTS AND SIGNIFICANTLY MORE DIFFICULTY IN ATTRACTING CUSTOMERS We have entered into an advertising agreement with Amazon.com whereby Amazon.com provides us with online promotions mutually agreed upon, such as emails about Pets.com, and one or more links from different locations on its Web site to our Web store, consistent with Amazon.com's other marketing arrangements. We experienced increases in traffic to our Web store after the initiation of these promotions and have begun to derive traffic from the Amazon.com Web site. Although our current agreement with Amazon.com expires in October 2000, Amazon.com could terminate most of these online promotions at any time. We cannot be certain that our relationship with Amazon.com will be available to us in the future on acceptable commercial terms, if at all. If we are

unable to maintain our relationship with Amazon.com or agree upon the terms and conditions of continuing the agreement beyond October 2000, our customer traffic could fall and our brand identity could be adversely impacted resulting in decreased revenues, and our marketing expenses could increase as we are forced to incur higher costs to attract customers. In addition, our relationship with Amazon.com is not exclusive. Amazon.com could partner with any of our competitors or offer competing products, information or services directly from its Web site. Furthermore, by virtue of the fact that we derive traffic directly from the Amazon.com Web site, any interruption in service of Amazon.com's Web site or the distribution of products to its customers could reduce the number of customers to our Web store and reduce our revenues. Because we depend on the brand awareness of Amazon.com to help build our brand, negative publicity about Amazon.com or a reduction of the effectiveness of its brand could also have a negative impact on our brand and reduce our revenues.

WE UTILIZE CONSULTING ADVICE AND SUPPORT FROM AMAZON.COM FOR OPERATIONAL AND STRATEGIC EXPERTISE. AMAZON.COM HAS NO CONTRACTUAL OBLIGATION TO PROVIDE THIS SUPPORT. IF AMAZON.COM DOES NOT CONTINUE TO PROVIDE THE ADVICE AND SUPPORT WE NEED, WE COULD INCUR HIGHER OPERATIONAL EXPENSES IN RUNNING OUR BUSINESS AND DIFFICULTIES IN EXECUTING ON OUR BUSINESS PLAN Since our inception, Amazon.com has provided us with free consulting services relating to the operation of our business. During this time, Amazon.com has also provided us with assistance in negotiating with vendors who also do business with Amazon.com. This assistance has allowed us to incur significantly lower operational expenses than we could otherwise have achieved at our early stage of development. Amazon.com has provided these services to us because of Amazon.com's significant equity stake in us. Amazon.com, however, is under no contractual obligation to continue to provide this advice and support. While Amazon.com will continue to own over % of our common stock after this offering, we cannot be certain that Amazon.com will continue to provide, or provide at all, the level of consulting advice and support that Amazon.com has provided to us in the past. If we are unable to maintain our relationship with Amazon.com, we would lose access to important operational and strategic expertise, which could harm our business.

WE DEPEND ON OUR ABILITY TO BUILD AND MAINTAIN RELATIONSHIPS WITH OUR SUPPLIERS TO OBTAIN SUFFICIENT QUANTITIES OF QUALITY MERCHANDISE ON ACCEPTABLE COMMERCIAL TERMS. IF WE FAIL TO MAINTAIN OUR SUPPLIER RELATIONSHIPS, OUR REVENUES WILL DECLINE Our business strategy depends on providing a large selection of well-known and high-quality branded products which in turn depends on our ability to maintain relationships with a significant number of suppliers. We currently purchase our products from approximately 200 suppliers. Our contracts or arrangements with suppliers do not guarantee the availability of merchandise, establish guaranteed prices or provide for the continuation of particular pricing practices. Our current suppliers may not continue to sell products to us on current terms or at all, and we may not be able to establish new suppliers to ensure delivery of products in a timely manner or on terms acceptable to us. Furthermore, because many of the products offered on our Web store are well-known branded products, if suppliers of these products do not supply products to us, we may lose customers who are unwilling to substitute for other brands we carry. We are also dependent on

suppliers for assuring the quality of products supplied to us. Because we ship products directly to our customers, if the quality of products supplied to us fall below our customers' expectations, we may lose customers. In addition, our supply contracts do not restrict our suppliers from selling products to our online competitors or to retailers other than online retailers, which could limit our ability to supply the quantity of products requested by our customers. We are also subject to the risks our suppliers face, including employee strikes and inclement weather. Our failure to deliver a large selection of high-quality and well-known branded products to our customers in a timely and accurate manner, and at acceptable prices, would harm our reputation, the Pets.com brand and our results of operations.

WE FACE THE RISK OF SYSTEMS INTERRUPTIONS AND CAPACITY CONSTRAINTS ON OUR WEB SITE, POSSIBLY RESULTING IN ADVERSE PUBLICITY, REVENUE LOSSES AND EROSION OF CUSTOMER TRUST The satisfactory performance, reliability and availability of our Web store, transaction processing systems and network infrastructure are critical to our reputation and our ability to attract and retain customers and to maintain adequate customer service levels. Any future systems interruption that results in the unavailability of our Web store or reduced order fulfillment performance could result in negative publicity and reduce the volume of goods sold and the attractiveness of our Web store, which could negatively affect our revenues. For the nine months ended September 30, 1999, there were three periods of one to three hours and one period of thirteen hours during which users were able to access our site but unable to complete transactions. There was also one period of two hours during which our site was not accessible as a result of scheduled maintenance. Nevertheless, we may experience temporary system interruptions for a variety of reasons in the future, including power failures, software bugs and an overwhelming number of visitors trying to reach our Web store during sales or other promotions. We may not be able to correct a problem in a timely manner. Because we are dependent in part on outside consultants for the implementation of certain aspects of our system and because some of the reasons for a systems interruption may be outside of our control, we also may not be able to remedy the problem quickly or at all.

We opened our Web store for customers in February 1999 and to the extent that customer traffic grows substantially, we will need to expand the capacity of our systems to accommodate a larger number of visitors. Any inability to scale our systems may cause unanticipated system disruptions, slower response times, degradation in levels of customer service, impaired quality and speed of order fulfillment, or delays in reporting accurate financial information. We are not certain that we will be able to project the rate or timing of increases, if any, in the use of our Web store accurately or in a timely manner to permit us to effectively upgrade and expand our transaction-processing systems or to integrate smoothly any newly developed or purchased modules with our existing systems.

WE HAVE GROWN VERY RAPIDLY. THIS GROWTH HAS PLACED, AND OUR ANTICIPATED FUTURE OPERATIONS WILL CONTINUE TO PLACE, A SIGNIFICANT STRAIN ON OUR MANAGEMENT SYSTEMS AND RESOURCES. WE WILL NOT BE ABLE TO IMPLEMENT OUR BUSINESS STRATEGY UNLESS WE ARE ABLE TO EFFECTIVELY MANAGE THIS STRAIN ON OUR SYSTEMS AND RESOURCES We have rapidly and significantly expanded our operations, and anticipate that we will continue to expand. From March 31, 1999 to September 30, 1999 to November 30, 1999 we grew from 4 to 123 to 260 employees, respectively. We currently have one distribution

center, and expect to begin operating a second distribution center in the first half of 2000 and a third distribution center within twenty-four months thereafter. This growth has placed, and our anticipated future operations will continue to place, a significant strain on our management systems and resources. We will not be able to implement our business strategy unless we are able to effectively manage this strain on our systems and resources. We will not be able to increase revenues unless we continue to improve our transaction-processing, operational, financial and managerial controls, reporting systems and procedures, expand, train, supervise and manage our work force, and manage multiple relationships with third parties.

WE ENTER INTO STRATEGIC RELATIONSHIPS TO HELP PROMOTE OUR WEB STORE. IF WE FAIL TO MAINTAIN OR ENHANCE THESE RELATIONSHIPS, OUR DEVELOPMENT COULD BE HINDERED We believe that our ability to attract customers, facilitate broad market acceptance of our products and the Pets.com brand, and enhance our sales and marketing capabilities depends on our ability to develop and maintain strategic relationships with Amazon.com, other pets-related Web sites and portals, and other Web sites that can drive customer traffic to our Web store. If we are unable to develop or maintain key relationships, we may have difficulty attracting and retaining customers.

COMPETITION FROM BOTH TRADITIONAL AND ONLINE RETAILERS MAY RESULT IN PRICE REDUCTIONS AND DECREASED DEMAND FOR OUR PRODUCTS AND SERVICES We compete in a market that is new, rapidly evolving and highly competitive, and we expect competition to intensify in the future. Increased competition could result in price reductions, fewer customer orders, reduced gross margins and loss of market share. We currently or potentially compete with a variety of companies, many of which have significantly greater financial, technical, marketing and other resources. These competitors can be divided into several groups: online stores that specialize in pet products such as Petopia.com, Inc., PetsMart.com, Inc. and PetStore.com, Inc., online stores that offer pet products, superstore retailers of pet products such as Petco Animal Supplies, Inc. and PetsMart, Inc., specialty pet stores, mass market retailers such as Wal Mart Stores, Inc., Kmart Corporation and Target Stores, Inc., supermarkets, warehouse clubs such as Costco Companies, Inc., mail order suppliers of pet products, and pet supply departments at major department stores. Many of these companies, which include national, regional and local chains, have existed for a longer period, have greater financial resources, have established marketing relationships with leading manufacturers and advertisers, and have longer established brand recognition among customers.

We believe we may face a significant competitive challenge from our competitors forming alliances with each other. For instance, Petopia, Inc. is owned in part by Petco Animal Supplies, Inc., and PetsMart.com, Inc. is owned in part by PetsMart, Inc. The combined resources of these alliances could pose a significant competitive challenge to Pets.com. These relationships may enable these online stores to achieve greater brand recognition, particularly in the case of PetsMart.com, Inc., by leveraging the better established brand awareness of their pet retail store partner. These relationships may also enable these online stores to negotiate better pricing and other terms from suppliers by aggregating their demand for products and negotiating volume discounts. Our inability to partner with a major pet store chain could be a major competitive disadvantage to us.

We also believe we may face significant competitive challenges from discount general merchandise stores, mass market retailers and other retailers that commence or expand their presence on the Internet to include pet products. Finally, we are aware of numerous other smaller entrepreneurial companies that are focusing significant resources on developing and marketing products, information and services that will compete directly with those offered at Pets.com.

We believe that there may be a significant advantage in establishing a large customer base before our competitors do so. If we fail to attract and retain a large customer base and our competitors establish a more prominent market position relative to ours, this could inhibit our ability to grow. We believe the principal factors in our market include brand recognition, product selection, quality of Web store content, reliability and speed of order shipment, customer service, speed and accessibility of our Web store, personalized service, convenience and price. We will have little or no control over how successful our competitors are in addressing these factors. In addition, with little difficulty, our online competitors can duplicate many of the products, services and content offered on our site.

EXPANSION OF OUR INTERNATIONAL OPERATIONS WILL REQUIRE MANAGEMENT ATTENTION AND RESOURCES AND MAY BE UNSUCCESSFUL WHICH COULD HARM OUR BUSINESS To date, we have conducted no international operations but we intend to make an investment in a UK-based company that intends to sell pet products online. We plan to build local versions of our Web store for foreign companies or expand our international operations through acquisitions or alliances with third parties. Our expansion plans will require management attention and resources and may be unsuccessful. We have no experience in selling our products to conform to local cultures, standards and policies. We may have to compete with local companies which understand the local market better than we do. In addition, to achieve satisfactory performance for consumers in international locations it will be necessary to locate physical facilities, such as server computers and distribution centers in the foreign market. We do not have experience establishing such facilities overseas. We may not be successful in expanding into any international markets or in generating revenues from foreign operations. In addition, different privacy, censorship and liability standards and regulations and different intellectual property laws in foreign countries may cause our business to be harmed. Furthermore, once we expand internationally we expect to incur net losses in developing foreign markets for the foreseeable future.

OUR SYSTEMS AND OPERATIONS, AND THOSE OF OUR SUPPLIERS AND SHIPPERS, ARE VULNERABLE TO NATURAL DISASTERS AND OTHER UNEXPECTED PROBLEMS Substantially all of our computer and communications hardware is located at our leased facility in San Francisco, California and our systems infrastructure is hosted at an Exodus Communications, Inc. facility in Santa Clara, California. Our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, earthquakes and similar events. In addition, our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays, loss of data or the inability to accept and fulfill customer orders. We do not currently have fully redundant systems or a formal disaster recovery plan and do not carry sufficient business interruption insurance to compensate for losses that may occur. Our suppliers also face these risks.

We also depend on the efficient operation of Internet connections from customers to our systems. These connections, in turn, depend on the efficient operation of Web browsers, Internet service providers and Internet backbone service providers, all of which have had periodic operational problems or experienced outages. Any system delays, failures or loss of data, whatever the cause, could reduce customer satisfaction with our applications and services and harm our sales.

GOVERNMENTAL REGULATION OF OUR BUSINESS COULD REQUIRE SIGNIFICANT EXPENSES, AND FAILURE TO COMPLY WITH CERTAIN REGULATIONS COULD RESULT IN CIVIL AND CRIMINAL PENALTIES Our business is subject to federal, state and local regulations relating to the shipment of pet food, live animals and pet products, advice relating to animal care, and other matters. Regulations in this area often require subjective interpretation, and we cannot be certain that our attempts to comply with these regulations will be deemed sufficient by the appropriate regulatory agencies. Violations of any regulations 11 could result in various civil and criminal penalties, including suspension or revocation of our licenses or registrations, seizure of our inventory, or monetary fines, which could adversely effect our operations.

WE NEED TO HIRE AND RETAIN A NUMBER OF ADDITIONAL TECHNOLOGY, CONTENT AND PRODUCT ORIENTED PERSONNEL WHO MIGHT BE DIFFICULT TO FIND We intend to continue to hire a significant number of additional personnel, including software engineers, editorial and customer support personnel, marketing personnel, and warehouse and operational personnel. Competition for these individuals is intense, and we may not be able to attract, assimilate or retain additional highly qualified personnel in the future. The failure to attract, integrate, motivate and retain additional such employees could seriously harm our business.

WE RELY ON THE SERVICES OF OUR KEY PERSONNEL, WHOSE KNOWLEDGE OF OUR BUSINESS AND TECHNICAL EXPERTISE WOULD BE DIFFICULT TO REPLACE We rely upon the continued service and performance of a relatively small number of key technical and senior management personnel. Our future success depends on our retention of these key employees, such as Julie Wainwright, our Chief Executive Officer. None of our key technical or senior management personnel are bound by employment agreements, and as a result, any of these employees could leave with little or no prior notice. If we lose any of our key technical and senior management personnel, our business could be seriously harmed. We do not have "key person" life insurance policies covering any of our employees.

MANY MEMBERS OF OUR MANAGEMENT TEAM ARE NEW TO THE COMPANY OR TO THE PET PRODUCTS AND SERVICES INDUSTRY OR ONLINE BUSINESSES, AND OUR BUSINESS COULD BE SERIOUSLY HARMED IF INTEGRATION OF OUR MANAGEMENT TEAM INTO OUR COMPANY IS NOT SUCCESSFUL We have recently experienced significant growth in our management team. Paul Manca, our Chief Financial Officer, joined us in September 1999 and Ralph Lewis, our Vice President of Distribution and Logistics, joined us in November 1999. In addition, many of the members of our senior management team do not have prior experience in the pet products and services industry or in online businesses or in publicly traded companies. Our business could be

seriously harmed if integration of our management team into our company is not successful. We expect that it will take time for our new management team to integrate into our company and it is too early to predict whether this integration will be successful.

WE CANNOT BE CERTAIN THAT WE WILL BE ABLE TO PROTECT OUR INTELLECTUAL PROPERTY, AND WE MAY BE FOUND TO INFRINGE PROPRIETARY RIGHTS OF OTHERS, WHICH COULD HARM OUR BUSINESS We rely on a combination of trademark, trade secret and copyright law and contractual restrictions to protect our intellectual property. These afford only limited protection. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our sales formats or to obtain and use information that we regard as proprietary, such as the technology used to operate our Web store, our content and our trademarks.

We have filed applications for the registration of Pets.com(TM), the Pets.com logo, Because Pets Can't Drive(TM), Keep It Comin'(TM), More Products Than a Superstore Delivers(TM), People Helping Animals, Animals Helping People(TM), and Pets.commitment(TM) in the U.S. and in some other countries, although we have not secured registration of our marks to date. We have been granted the right to use Pets.complete(TM) from a third party in exchange for economic consideration. We may be unable to secure these registrations. It is also possible that our competitors or others will adopt service names similar to ours, thereby impeding our ability to build brand identity and possibly leading to customer confusion. In addition, there could be potential trade name or trademark infringement claims brought by owners of other registered trademarks or trademarks that incorporate variations of the term Pets.com or our other trademark applications. Any claims or customer confusion related to our trademarks, or our failure to obtain any trademark registration, would negatively affect our business.

Litigation or proceedings before the U.S. Patent and Trademark Office may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets and domain names and to determine the validity and scope of the proprietary rights of others. Any litigation or adverse priority proceeding could result in substantial costs and diversion of resources and could seriously harm our business and operating 12 results. Finally, we intend to sell our products internationally, and the laws of many countries do not protect our proprietary rights to as great an extent as do the laws of the United States.

Third parties may also claim infringement by us with respect to past, current or future technologies. We expect that participants in our markets will be increasingly subject to infringement claims as the number of services and competitors in our industry segment grows. Any claim, whether meritorious or not, could be time-consuming, result in costly litigation, cause service upgrade delays or require us to enter into royalty or licensing agreements. These royalty or licensing agreements might not be available on terms acceptable to us or at all.

WE MAY NOT BE ABLE TO PROTECT OUR DOMAIN NAMES IN ALL COUNTRIES OR AGAINST ALL INFRINGERS, WHICH COULD DECREASE THE VALUE OF OUR BRAND NAME AND PROPRIETARY RIGHTS We currently hold the Internet domain name "pets.com," as well as various other related names. Domain names generally are regulated by Internet regulatory bodies. The regulation of domain names in the United States and in foreign countries is subject to change.

Regulatory bodies could establish additional top-level domains, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may not be able to acquire or maintain the domain names in all of the countries in which we conduct business which utilize the term "pets" or "pets.com." We are aware that other entities have already registered domain names utilizing the term "pets" or "pets.com." If we are unable to purchase these names from these entities on commercially reasonable terms or in the event we were to otherwise lose the ability to use a domain name in a particular country, we would be forced to incur significant additional expenses to market our products within that country, including the development of a new brand and the creation of new promotional materials and packaging.

WE ARE SUBJECT TO PRODUCT LIABILITY CLAIMS AND MAY FACE LIABILITY FOR CONTENT ON OUR WEB STORE, ANY OF WHICH COULD HARM OUR FINANCIAL CONDITION AND LIQUIDITY Because we sell consumer products we may be subject to product liability claims resulting from injuries to persons and animals caused by the products we sell. We maintain limited product liability insurance. To the extent these claims are not covered by or are in excess of our product liability insurance, a successful product liability claim could harm our financial condition and liquidity. In addition, because we post product information and other content on our Web store and permit our customers to place content on our bulletin board systems and in other areas of our Web store, we face potential liability for negligence, copyright, patent, trademark, defamation, indecency and other claims based on the nature and content of the materials that we post or permit our customers to post. Such claims have been brought, and sometimes successfully pressed, against Internet content distributors. In addition, we do not and cannot practically screen all of the content generated by our users and placed on our Web store. Although we maintain general liability insurance of $3 million, our insurance may not cover potential claims of this type or may not be adequate to indemnify us for all liability that may be imposed. Any imposition of liability that is not covered by insurance or is in excess of insurance coverage could harm our financial condition and liquidity.

OUR OPERATIONS MAY BE DISRUPTED IF WE OR OUR PRODUCT SUPPLIERS OR OTHER VENDORS EXPERIENCE SYSTEMS FAILURE OR DATA CORRUPTION FROM THE YEAR 2000 ISSUE Any failure of our material systems, our product suppliers or others vendors' material systems or the Internet to be year 2000 compliant would have material adverse consequences for us. Such consequences would include difficulties in operating our Web store effectively, taking product orders, making product deliveries or conducting other fundamental parts of our business. We may be unable to detect or assess the effect of any failure well into the year 2000 and beyond. We are currently assessing the year 2000 readiness of the software, computer technology and other services that we use which may not be year 2000 compliant. We do not intend to develop a contingency plan to address situations that may result if our vendors or we experience material difficulties after January 1, 2000 as a result of the year 2000 problem.

We also depend on the year 2000 compliance of the computer systems and financial services used by consumers. A significant disruption in the ability of consumers to reliably access the Internet or portions of it or to use their credit cards would have an adverse effect on demand for our products and

services. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Year 2000" for a further description of the issues we face with regard to the year 2000.

AMAZON.COM, OUR OTHER EXISTING STOCKHOLDERS, AND OUR OFFICERS AND DIRECTORS, WILL STILL CONTROL THE MAJORITY OF OUR COMMON STOCK AFTER THIS OFFERING, WHICH COULD DISCOURAGE AN ACQUISITION OF US OR MAKE REMOVAL OF INCUMBENT MANAGEMENT MORE DIFFICULT After this offering, Amazon.com will beneficially own approximately % of our outstanding common stock, % if the underwriters' over-allotment option is exercised in full, and Randy Tinsley, Amazon.com's Vice President, Corporate Development, is a member of our Board of Directors. Therefore, Amazon.com will be able to significantly influence all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions. Amazon.com's substantial equity stake in us could also make us a much less attractive acquisition candidate to potential acquirors, because Amazon.com would be able to block the acquisition by acting in concert with only a small number of other stockholders. In addition, Amazon would have sufficient votes to prevent the tax-free treatment of an acquisition. In addition, executive officers, directors and entities affiliated with them, including Amazon.com, will, in the aggregate, beneficially own approximately % of our outstanding common stock following the completion of this offering, % if the underwriters' over-allotment option is exercised in full. These stockholders, if acting together, would be able to decide all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions. See "Principal Stockholders" for a description of Amazon.com's stock ownership relative to other stockholders, "Executive Officers and Directors" for background on Randy Tinsley, and "Related Party Transactions" for a description of our agreements with Amazon.com.

## *Risks Related to Internet Commerce*

WE DEPEND ON CONTINUED USE OF THE INTERNET, AND IF THE USE OF THE INTERNET DOES NOT DEVELOP AS WE ANTICIPATE, OUR SALES MAY NOT GROW Our future revenues and profits, if any, substantially depend upon the widespread acceptance and use of the Internet as an effective medium of business and communication by our target customers. Rapid growth in the use of and interest in the Internet has occurred only recently. As a result, acceptance and use may not continue to develop at historical rates, and a sufficiently broad base of consumers may not adopt, and continue to use, the Internet and other online services as a medium of commerce.

In addition, the Internet may not be accepted as a viable long-term commercial marketplace for a number of reasons, including potentially inadequate development of the necessary network infrastructure or delayed development of enabling technologies and performance improvements. Our success will depend, in large part, upon third parties maintaining the Internet infrastructure to provide a reliable network backbone with the speed, data capacity, security and hardware necessary for reliable Internet access and services.

OUR SUCCESS DEPENDS ON THE WILLINGNESS OF CONSUMERS TO PURCHASE PET PRODUCTS OVER THE INTERNET INSTEAD OF THROUGH TRADITIONAL RETAILERS. CONSUMERS MAY NOT BE WILLING TO DO THIS The online market for pet products, information and services is in its infancy. The market is significantly less developed than the online market for books, auctions, music, software and numerous other consumer products. If this market does not gain widespread acceptance, our business may fail. Demand and market acceptance for recently introduced services and products on the Internet are subject to a high level of uncertainty, and there are few proven services and products. Our success will depend on our ability to engage consumers who have historically purchased pet products through traditional retailers. In order for us to be successful, many of these consumers must be willing to utilize new ways of buying pet products. In addition, a substantial proportion of the consumers who use our Web store may be using our service because it is new and different rather than because they believe it is a desirable way to purchase pet products. Such consumers may use our service only once or twice and then return to more familiar means of purchasing these products.

## *Our Sales Could Be Negatively Affected If We Are Required to Charge Taxes on Purchases*

We do not collect sales or other similar taxes in respect of goods sold by Pets.com, except from purchasers located in California. However, one or more states or the federal government may seek to impose sales tax collection obligations on out-of-state companies, such as Pets.com, which engage in or facilitate online commerce, and a number of proposals have been made at the state and local level that would impose additional taxes on the sale of goods and services through the Internet. In 1998, the U.S. federal government enacted legislation prohibiting states or other local authorities from imposing new taxes on Internet commerce for a three-year period, ending on October 1, 2001. This tax moratorium does not prohibit states or the Internal Revenue Service from collecting taxes on our income, if any, or from collecting taxes that are due under existing tax rules. A successful assertion by one or more states or any foreign country that we should collect sales or other taxes on the exchange of merchandise on our Web store could harm our business. In addition, a number of trade groups and government entities have publicly stated their objections to this tax moratorium and have argued for its repeal. The Federal Advisory Commission on Electronic Commerce is in the process of evaluating these issues. It is expected to make its recommendation to Congress in April 2000. There can be no assurance that future laws will not impose taxes or other regulations on Internet commerce, or that such three-year moratorium will not be repealed, or that it will be renewed when it expires, any of which events could substantially impair the growth of electronic commerce.

We intend to open distribution centers from time to time in other states and, regardless of the outcome of this federal tax moratorium, may be required to collect sales or other similar taxes in respects of goods sold by Pets.com into these states. A successful assertion by one or more states or the federal government that we should collect further sales or other taxes on the sales of products through Pets.com could negatively affect our revenues and business.

WE RELY ON THIRD-PARTY CARRIERS FOR PRODUCT SHIPMENTS TO US AND OUR CUSTOMERS, AND COULD LOSE CUSTOMERS IF THESE CARRIERS DO NOT ADEQUATELY SERVE OUR NEEDS We rely upon third-party carriers for product shipments, including shipments to and from our distribution facility. We are therefore subject to the risks, including employee strikes and inclement weather, associated with such carriers' ability to provide delivery services to meet our shipping needs. In addition, failure to deliver products to our customers in a timely manner would damage our reputation and brand.

BECAUSE WE ARE UNABLE TO OBTAIN SIGNATURES FROM OUR CUSTOMERS WHEN WE PROCESS ORDERS ONLINE, WE ARE EXPOSED TO RISKS ASSOCIATED WITH CREDIT CARD FRAUD A failure to adequately control fraudulent credit card transactions would harm our net sales and results of operations because we do not carry insurance against this risk. Under current credit card practices, we are liable for fraudulent credit card transactions because we do not obtain a cardholder's signature. To date, we have experienced almost no losses from credit card fraud, but we face the risk of significant losses from this fraud as our sales increase. Our failure to adequately control fraudulent credit card transactions could reduce our collections and harm our business.

OUR BUSINESS COULD BE HARMED IF WE FAIL TO PREVENT ONLINE COMMERCE SECURITY BREACHES. WE MAY NEED TO EXPEND SIGNIFICANT RESOURCES TO PROTECT AGAINST SECURITY BREACHES OR TO ADDRESS PROBLEMS CAUSED BY BREACHES A significant barrier to online commerce and communications is the secure transmission of confidential information over public networks, and our failure to prevent security breaches could harm our business. Currently, a significant number of our users authorize us to bill their credit card accounts directly for all products sold by us. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication technology to effect secure transmission of confidential information, including customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography, or other developments may result in a compromise or breach of the technology used by us to protect customer transaction data. Any such compromise of our security could harm our reputation and expose us to a risk of loss or litigation and possible liability and, therefore, harm our business. In addition, a party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. We may need to expend significant resources to protect against security breaches or to address problems caused by breaches. Security breaches could damage our reputation. Our insurance policies carry low coverage limits, which may not be adequate to reimburse us for losses caused by security breaches.

IF WE DO NOT RESPOND TO RAPID TECHNOLOGICAL CHANGES, OUR SERVICES COULD BECOME OBSOLETE AND OUR BUSINESS WOULD BE SERIOUSLY HARMED As the Internet and online commerce industry evolve, we must license leading technologies useful in our business, enhance our existing services, develop new services and technology that address the increasingly sophisticated and varied needs of our prospective customers and respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis. We may not be able to successfully implement new technologies or adapt our Web store, proprietary technology and

transaction-processing systems to customer requirements or emerging industry standards. If we are unable to do so, it could adversely impact our ability to build the Pets.com brand and attract and retain customers.

GOVERNMENTAL REGULATION OF THE INTERNET AND DATA TRANSMISSION OVER THE INTERNET MAY NEGATIVELY AFFECT OUR CUSTOMERS AND RESULT IN A DECREASE IN DEMAND FOR OUR PRODUCTS, WHICH WOULD CAUSE A DECLINE IN OUR SALES Laws and regulations directly applicable to communications or commerce over the Internet are becoming more prevalent. The most recent session of the U.S. Congress resulted in Internet laws regarding children's privacy, copyrights, taxation and the transmission of sexually explicit material. The European Union recently enacted its own privacy regulations. The law of the Internet, however, remains largely unsettled, even in areas where there has been some legislative action. It may take years to determine whether and how existing laws such as those governing privacy, libel and taxation apply to Web stores such as ours. The delays that these governmental processes entail may cause order cancellations or postponements of product purchases by our customers, which would seriously harm our business. The rapid growth and development of the market for online commerce may prompt calls for more stringent consumer protection laws, both in the United States and abroad, that may impose additional burdens on companies conducting business online. The adoption or modification of laws or regulations relating to the Internet business could result in a decrease in demand for our products, which would cause a decline in our revenues.

## *Risks Related to This Offering*

OUR STOCK PRICE WILL FLUCTUATE AFTER THIS OFFERING, WHICH COULD RESULT IN SUBSTANTIAL LOSSES FOR INVESTORS Although the initial public offering price will be determined based on several factors, the market price for our common stock will vary from the initial offering price after trading commences. This could result in substantial losses for investors. The market price of our common stock may fluctuate significantly in response to a number of factors, some of which are beyond our control. These factors include:

- Quarterly variations in operating results;

- Changes in financial estimates by securities analysts;

- Announcements by us or our competitors, of new product and service offerings, significant contracts, acquisitions or strategic relationships;

- Publicity about our company, our products and services, our competitors, or e-commerce in general;

- Additions or departures of key personnel;

- Any future sales of our common stock or other securities; and - Stock market price and volume fluctuations of publicly-traded companies in general and Internet-related companies in particular, especially Amazon.com.

The trading prices of Internet-related companies and e-commerce companies, including Amazon.com, have been especially volatile and many are at or near historical highs. Investors may be unable to resell their shares of our common stock at or above the offering price. In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. We may be the target of similar litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources, which could seriously harm our business and operating results.

A TOTAL OF 26,068,921 SHARES, OR %, OF OUR TOTAL OUTSTANDING SHARES AFTER THE OFFERING ARE RESTRICTED FROM IMMEDIATE RESALE, BUT MAY BE SOLD INTO THE MARKET IN THE NEAR FUTURE. THIS COULD CAUSE THE MARKET PRICE OF OUR COMMON STOCK TO DROP SIGNIFICANTLY, EVEN IF OUR BUSINESS IS DOING WELL Our current stockholders hold a substantial number of shares, which they will be able to sell in the public market in the near future. Sales of a substantial number of shares of our common stock could cause our stock price to fall. In addition, the sale of these shares could impair our ability to raise capital through the sale of additional stock.

```
     After this offering, we will have outstanding             shares of common
stock. This includes             shares that we are selling in the offering,
which may be resold immediately in the public market. The remaining 26,068,921
shares will become eligible for resale in the public market as shown in the
table below.
```

NUMBER OF SHARES/PERCENT OUTSTANDING AFTER THE OFFERING DATE OF AVAILABILITY FOR RESALE INTO PUBLIC MARKET

```
/      %        180 days after the date of the final prospectus due to
                  agreements these stockholders have with us and the
                  underwriters. However, the underwriters can waive this
                  restriction without prior notice and allow these
                  stockholders to sell their shares at any time.
/      %        At various times between 180 days after the date of the
                  final prospectus and November 5, 2000             shares
                  will be eligible for sale pursuant to Rule 144.
/      %        At various times between November 5, 2000 and December 8,
                  2000,             shares will be eligible for sale
                  pursuant to Rule 144.
/      %        At various times after December 8, 1999,             shares
                  will be eligible for sale pursuant to Rule 144.
```

NEW STOCKHOLDERS WILL INCUR SUBSTANTIAL DILUTION OF APPROXIMATELY $ PER SHARE AS A RESULT OF THIS OFFERING The initial public offering price is expected to be substantially higher than the book value per share of our outstanding common stock. As a result, investors purchasing common stock in this offering will incur immediate substantial dilution of approximately $ per share. In addition, we have issued options to acquire common stock at prices significantly below the initial public offering price. To the extent such outstanding options are ultimately exercised, there will be further dilution to investors in this offering. See "Dilution" for a more detailed description of how new stockholders will incur dilution.

# *Forward-looking Statements*

This prospectus contains forward-looking statements that involve risks and uncertainties. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expect, plan, intend, anticipate, believe, estimate, predict, potential or continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. In evaluating these statements, you should specifically consider various factors, including the risks outlined in the Risk Factors section above. These factors may cause our actual results to differ materially from any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

# *Use of Proceeds*

Our net proceeds from the sale of the shares of common stock we are offering hereby are estimated to be $79.9 million, or $92.0 million if the underwriters' option to purchase additional shares is exercised in full, based on an initial offering price of $ per share and after deducting the underwriting discounts and commissions and estimated offering expenses.

The principal purposes of this offering are to fund our operating losses, increase our working capital, fund our capital expenditures, create a public market for our common stock, and facilitate our future access to the public capital markets. We currently expect to use the net proceeds of this offering primarily for working capital and general corporate purposes, including marketing and brand building efforts, capital expenditures associated with the expansion and building of distribution centers, and technology and system upgrades. We are in the process of building a second distribution center which will require capital investments in facilities and equipment of $7 million to $9 million. We have not yet determined the actual expected expenditures and thus cannot estimate the amounts to be used for each of these purposes. The amounts and timing of these expenditures will vary depending on a number of factors, including the amount of cash generated by our operations, competitive and technological developments and the rate of growth, if any, of our business. In addition, we may use a portion of the net proceeds for further development of our product lines through acquisitions of products, technologies and businesses. Accordingly, although we have no present commitments or agreements with respect to any such acquisitions, management will have significant discretion in applying the net proceeds of this offering. Pending such uses, we will invest the net proceeds in short-term, investment grade, interest-bearing securities.

# *Dividend Policy*

We have never declared or paid cash dividends on our capital stock. We currently intend to retain all available funds and any future earnings for use in the operation of our business and do not anticipate paying any cash dividends in the foreseeable future.

# *Capitalization*

The following table sets forth our capitalization as of September 30, 1999. Our capitalization is presented:

- On an actual basis;

- On a pro forma basis to give effect to the automatic conversion of all of the outstanding shares of our convertible preferred stock into shares of common stock upon the closing of this offering; and - On a pro forma as adjusted basis to reflect the automatic conversion of all of the outstanding shares of our convertible preferred stock and our receipt of the estimated net proceeds from the sale of shares of common stock in this offering at an estimated price of $ per share.

SEPTEMBER 30, 1999 PRO FORMA ACTUAL PRO FORMA AS ADJUSTED (IN THOUSANDS) Stockholders' equity: Preferred stock, $0.001 par value, no shares authorized, issued or outstanding, actual and pro forma; 5,000,000 shares authorized, no shares issued or outstanding, pro forma as adjusted..... $ -- $ -- $ -- Convertible Preferred Stock, $0.001 par value; Series A -- 7,227,328 shares authorized; 7,227,328 shares issued and outstanding actual; none authorized, issued or outstanding, pro forma and pro forma as adjusted..... 7 -- -- Series B -- 6,900,000 shares authorized; 6,622,517 shares issued and outstanding actual; none authorized, issued or outstanding, pro forma and pro forma as adjusted..... 7 -- -- Common Stock $0.001 par value; 30,000,000 shares authorized, actual and pro forma; 5,098,746 shares issued and outstanding, actual; 18,948,591 shares issued and outstanding, pro forma; 150,000,000 shares authorized, shares issued and outstanding, pro forma as adjusted..... 5 19 Additional paid-in capital..... 73,671 73,671 Accumulated deficit..... (19,355) (19,355) (19,355) Stock-based compensation..... (11,751) (11,751) (11,751) Total stockholders' equity..... 42,584 42,584 122,454 Total capitalization..... $ 42,584 $ 42,584 $122,454 In addition to the shares of common stock to be outstanding after the offering, we may issue additional shares of common stock under the following plans and arrangements:

- 1,335,250 shares issuable upon exercise of options outstanding at a weighted average exercise price of $1.48 per share as of December 9, 1999; and - a total of 2,500,000 shares available for future issuance under our various stock plans at December 9, 1999, excluding the annual increases in the number of shares authorized under each of our plans beginning January 1, 2001. See "Management -- Stock Plans" for a description of how these annual increases are determined.

This information also excludes 1,073,750 shares issuable upon exercise of options granted from October 1, 1999 to December 9, 1999. Please read this capitalization table together with the sections of this prospectus entitled "Selected Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and with the financial statements and related notes beginning on page F-1.

# *Dilution*

Our pro forma net tangible book value as of September 30, 1999 was approximately $42.6 million or $2.25 per share of common stock. Pro forma net tangible book value per share represents the amount of our total tangible assets reduced by the amount of our total liabilities and divided by the total number of shares of common stock outstanding, after giving effect to the automatic conversion of our convertible preferred stock. Dilution in pro forma net tangible book value per share represents the difference between the amount per share paid by purchasers of shares of common stock in this offering and the pro forma net tangible book value per share of common stock immediately after the completion of this offering. After giving effect to the sale of the shares of common stock offered by Pets.com at an assumed initial public offering price of $ per share, and after deducting the underwriting discounts and commissions and estimated offering expenses payable by us, our pro forma net tangible book value as of September 30, 1999 would have been approximately $122.5 million or $ per share of common stock. This represents an immediate increase in pro forma net tangible book value of $ per share to existing stockholders and an immediate dilution of $ per share to new investors of common stock. The following table illustrates this per share dilution:

Assumed initial public offering price per share..... $ Pro forma net tangible book value per share as of September 30, 1999..... $2.25 Increase per share attributable to new investors..... Pro forma net tangible book value per share after this offering..... Dilution per share to new investors..... $ The following table summarizes on a pro forma basis after giving effect to the offering at an initial public offering price of $ per share, as of September 30, 1999, the differences between the existing stockholders and new investors with respect to the number of shares of common stock purchased from us, the total consideration paid to us and the average price per share paid.

| | SHARES PURCHASED | | TOTAL CONSIDERATION | | |
|---|---|---|---|---|---|
| | NUMBER | PERCENT | AMOUNT | PERCENT | AVERAGE PRICE PER SHARE |
| Existing stockholders..... | 18,948,591 | % | $60,800,000 | % | $3.21 |
| New investors..... | | | | | |
| Totals..... | | 100.0% | $ | 100.0% | |

The foregoing discussions and tables are based upon the number of shares actually issued and outstanding as of September 30, 1999 and assume no exercise of options outstanding as of September 30, 1999. As of that date there were 901,000 shares issuable upon exercise of options outstanding at a weighted average exercise price of $0.67 per share.

Assuming the exercise in full of all outstanding options, our pro forma as adjusted net tangible book value at September 30, 1999 would be $ per share, representing an immediate increase in net tangible book value of $ per share to our existing stockholders, and an immediate decrease in the net tangible book value per share of $ to the new investors.

# *Selected Financial and Operating Data*

The selected financial and operating data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations", our financial statements and the notes thereto and the other information contained in this prospectus. The selected balance sheet data as of September 30, 1999 and the selected statement of operations data for the period from February 17, 1999 (inception) to September 30, 1999 have been derived from our audited financial statements appearing elsewhere in this prospectus. The selected balance sheet data as of June 30, 1999 and the statement of operations data for the quarters ended June 30, 1999 and September 30, 1999 have been derived from our unaudited financial statements not included in this prospectus. We prepared the unaudited financial statements on substantially the same basis as the audited financial statements and, in our opinion, they include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of our financial condition as of June 30, 1999 and our results of operations for the quarters ended June 30, 1999 and September 30, 1999. The historical results presented below are not necessarily indicative of future results.

The calculation of pro forma net loss per share gives effect to the automatic conversion of all of the outstanding shares of our convertible preferred stock into shares of common stock upon the completion of this offering.

# *Selected Financial Data*

| | QUARTER ENDED JUNE 30, 1999 | QUARTER ENDED SEPTEMBER 30, 1999 | PERIOD FROM FEBRUARY 17, 1999 (INCEPTION) TO SEPTEMBER 30, 1999 |
|---|---|---|---|
| STATEMENTS OF OPERATIONS: | | | |
| Net sales | $ 39 | $ 568 | $ 619 |
| Cost of goods sold | (76) | (1,766) | (1,842) |
| Gross margin | (37) | (1,198) | (1,223) |
| Operating expenses: | | | |
| Marketing and sales | 1,122 | 10,693 | 11,815 |
| Product development | 1,624 | 2,194 | 3,835 |
| General and administrative | 838 | 1,205 | 2,043 |
| Amortization of stock-based compensation | -- | 1,139 | 1,139 |
| Total operating expenses | 3,584 | 15,231 | 18,832 |
| Operating loss | (3,621) | (16,429) | (20,055) |
| Interest income, net | 123 | 577 | 700 |
| Net loss | $ (3,498) | $ (15,852) | $ (19,355) |
| Basic and diluted net loss per share | $ (1.93) | $ (8.75) | $ (10.84) |
| Weighted average shares outstanding used to compute basic and diluted net loss per share | 1,811,837 | 1,811,837 | 1,786,156 |
| Pro forma basic and diluted net loss per share | | | $ (1.24) |
| Weighted average shares outstanding used to | | | |

| | |
|---|---|
| compute pro forma basic and diluted net loss per share | 15,636,001 |

| | JUNE 30, 1999 | SEPTEMBER 30, 1999 |
|---|---|---|
| BALANCE SHEET DATA: | | |
| Cash and cash equivalents | $55,355 | $36,231 |
| Working capital | 54,301 | 34,913 |
| Total assets | 58,487 | 48,399 |
| Convertible preferred stock and related paid-in capital | 60,382 | 60,382 |
| Total stockholders' equity | $60,449 | $42,584 |

# *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion should be read in conjunction with the Consolidated Financial Statements and the related Notes contained elsewhere in this prospectus.

# *Overview*

Pets.com is a leading online retailer of pet products, integrating product sales with expert information and professional resources. Our broad selection of approximately 12,000 SKUs transcends the limited product selection of superstores, specialty stores and grocery stores.

We were formed in February 1999. The assets related to the Web store, including the Pets.com domain name, were sold to Pets.com, Inc. from a third party concurrent with our first round of venture capital investment. The Company had a small amount of revenue during the second quarter of 1999 from a limited number of products available on our Web store. From inception through the launch of the second version of our Web store in July 1999, our operations were concentrated on the development of our Web store, the opening of a distribution center in San Francisco and establishing supplier and vendor relationships. Since July 1999, we have continued these operating activities and have also focused on building sales momentum, expanding our product offerings, building vendor relationships, promoting our brand name, improving the efficiency of our order fulfillment processes and improving our customer service operations.

We derive substantially all of our revenues from the online sale of pet products. We do not currently sell live animals such as fish or reptiles, but we may do so in the future. Virtually all of our orders are fulfilled from our distribution center and either billed to the customer's credit card or payment is received via check. Generally, we collect cash from credit cards in two to five days from the date ordered. If the pay-by-check method is selected, the order is shipped once the customer's check is deposited and funds are available. If a customer is not satisfied with a particular product or service we provide within 30 days of the date of purchase, we generally refund all or a portion of the sale. To date, our refunds have averaged less than 1% of net sales.

We have incurred net losses of $19.4 million from inception to September 30, 1999. We believe that we will continue to incur net losses for at least the next four years, and possibly longer, and that the rate at which we will incur such losses will increase significantly from current levels. We anticipate our losses will increase because we expect to incur additional costs and expenses related to brand development, marketing, and other promotional activities, distribution, customer service, content development, technology and infrastructure development and other capital expenditures.

Because we only began selling products in February 1999 and have yet to achieve meaningful revenues, we have a limited operating history on which to base an evaluation of our business and prospectus. You must consider our prospects in light of the risks, expenses and difficulties frequently encountered by companies in their early stage of development, particularly companies in new and rapidly evolving markets such as online commerce. These risks include, but are not limited to, an evolving and unpredictable business model and management of growth. To address these risks, we must, among other things, maintain and expand our customer base, implement and successfully execute our business and marketing strategy, continue to develop and upgrade our technology and systems that we use to process customers' orders and payments, improve our Web store, provide superior customer service, respond to competitive developments and attract, retain and motivate qualified personnel. We cannot assure you that we will be successful in addressing such risks, and our failure to do so could have a material adverse effect on our business, prospects, financial condition and results of operations.

Net Sales. Net sales consist of product sales and charges to customers for outbound shipping and handling and are net of allowances for product returns, promotional discounts and coupons. We recognize product and shipping revenues when the related product is shipped. In the future, the level of our sales will depend on a number of factors including, but not limited to, the frequency of our customers' purchases, the quantity and mix of products, pricing of products and shipping, sales promotions and discounts, seasonality and customer returns.

Cost of Sales and Gross Margin. Cost of sales consists primarily of the costs of products sold to customers and outbound and inbound shipping costs. We expect cost of sales to increase in absolute dollars to the extent that our sales volume increases. We may in the future expand or increase the coupons and discounts we offer to our customers and may otherwise alter our pricing structures and policies. These changes may negatively affect our gross margin. Our gross margin will fluctuate based on a number of factors, including, but not limited to the cost of our products, our product and shipping pricing strategy, product mix, our distribution centers and inventory control.

Marketing and Sales Expenses. Marketing and sales expenses consist primarily of advertising and promotional expenditures, supplies, payroll and related expenses for personnel engaged in marketing, merchandising and business development. We intend to continue to pursue an aggressive branding and marketing campaign and, therefore, expect marketing and sales expenses to increase significantly in absolute dollars. Marketing and sales expenses may also vary considerably as a percentage of net revenues from quarter to quarter, depending on the timing of our advertising campaigns.

Product Development Expenses. Product development expenses consist primarily of payroll and related expenses for our Web store development, systems personnel, consultants, content and other Web store costs. Over the next several months, we plan to continue to work on a significant number of development projects that will result in increased product development expenses. We believe that continued investment in product development is critical to attaining our strategic objectives and, as a result, we expect product development expenses to increase significantly in absolute dollars, but to fluctuate as a percentage of net revenue from quarter to quarter.

General and Administrative Expenses. General and administrative expenses consist of payroll and related expenses for development, design, production, finance, human resources, executive and administrative personnel, corporate facility expenses, professional services expenses, travel and other general corporate expenses. We expect general and administrative expenses to increase in absolute dollars as we expand our staff and incur additional costs related to the anticipated growth of our business and being a public company, but to fluctuate as a percentage of net revenue from quarter to quarter.

Amortization of Stock-Based Compensation. We recorded total stock-based compensation of $12.9 million for the period from inception on February 17, 1999 to September 30, 1999 in connection with stock options granted and restricted stock issued during such periods. In the case of stock options granted, the stock-based compensation amounts represent the difference between the exercise price of stock option grants and the deemed fair value of our common stock at the time of such grants. In the case of restricted stock, the stock-based compensation represents the difference between the purchase price of the restricted stock and the deemed fair value of our common stock on the date of purchase. Such amounts are amortized as an expense over the vesting periods of the applicable agreements, resulting in amortization of stock-based compensation totaling $1.1 million for the period from inception on February 17, 1999 to September 30, 1999. The amortization expense relates to options awarded to employees in all operating expense categories. Stock-based compensation for stock options and restricted stock issued through September 30, 1999 that will be subsequently recognized as expense for each of the next four years is estimated to be as follows:

# *Year Amount (In Thousands)*

| | | |
|---|---|---|
| 1999 (quarter ended December 31, 1999)..... | $ | 803 |
| 2000..... | $ | 3,210 |
| 2001..... | $ | 3,210 |
| 2002..... | $ | 3,210 |
| 2003..... | $ | 1,318 |

The amount of stock compensation expense to be recorded in future periods could decrease if options for which accrued but unvested compensation has been recorded are forfeited.

Income Taxes. There was no provision or benefit for income taxes for any period since inception due to our operating losses. As of September 30, 1999, we had $17.8 million of net operating loss carryforwards for federal income tax purposes, which expire beginning in 2019. We have not recognized any benefit from the future use of loss carryforwards for these periods or for any other

period since inception because of uncertainty surrounding their realization. The amount of net operating losses that we can utilize may be limited under tax regulations in circumstances including a cumulative stock ownership change of more than 50% over a three year period. It is possible that such a change may have already occurred or could occur as a result of this offering. See Note 4 of Notes to Consolidated Financial Statements.

## *Results of Operations*

We have not provided year-to-year comparative quarterly results because we only commenced operations in February 1999.

## *Liquidity and Capital Resources*

Since inception, we have financed our operations primarily through private sales of preferred stock, which, through September 30, 1999, yielded net cash proceeds of $60.0 million.

Net cash used in operating activities was $16.6 million from inception on February 17, 1999 to September 30, 1999. Net cash used in operating activities for this period primarily consisted of net losses, increases in inventories and other working capital purposes.

Net cash used in investing activities was $7.6 million from inception on February 17, 1999 to September 30, 1999. Net cash used in investing activities primarily consisted of leasehold improvements and purchases of equipment and systems, including computer equipment and fixtures and furniture.

Net cash provided by financing activities was $60.4 million from inception on February 17, 1999 to September 30, 1999. Net cash provided by financing activities during each of those periods primarily consisted of cash proceeds from the issuances of preferred stock. In April 1999 we issued 7,227,328 shares of Series A preferred stock in exchange for an aggregate purchase price of $10.0 million. In June 1999 we issued 6,622,517 shares of Series B preferred stock in exchange for an aggregate purchase price of $50.0 million.

As of September 30, 1999 we had $36.2 million of cash and cash equivalents. As of that date, our principal commitments consisted of obligations outstanding under operating leases aggregating approximately $1.4 million through September 30, 2000. In November 1999 we invested $2 million for an equity position in PetPlace.com, Inc. and are committed to invest an additional $1.5 million no later than February 2000. Although we have no material commitments for capital expenditures, we anticipate a increase in our capital expenditures and lease commitments consistent with anticipated growth in operations, infrastructure and personnel. In the first half of 2000, we intend to add a second distribution center to ensure greater control over the distribution process and to ensure adequate supplies of products to our customers. The second distribution center is in the final planning stages and will require capital investments in facilities and equipment of $7 million to $9 million. For 2000, we anticipate our total capital expenditures will be at least $15 million, which will include substantial

expenditures toward technology and systems upgrades to support the distribution centers and increases in business volume. In November and December 1999, we issued 6,523,181 shares of Series B preferred stock in exchange for an aggregate purchase price of $49.3 million.

We currently anticipate that the net proceeds of this offering, together with our available funds, will be sufficient to meet our anticipated needs for working capital and capital expenditures through at least the next 12 months. We may need to raise additional funds prior to the expiration of such period if, for example, we pursue business or technology acquisitions or experience operating losses that exceed our current expectations. If we raise additional funds through the issuance of equity, equity-related or debt 24 securities, such securities may have rights, preferences or privileges senior to those of the rights of our common stock and our stockholders may experience additional dilution. We cannot be certain that additional financing will be available to us on acceptable terms when required, or at all.

## *Year 2000*

Many existing computer programs use only two digits to identify a year. These programs were designed and developed without addressing the impact of the upcoming change in the century. If not corrected, many computer software applications could fail or create erroneous results by, at or beyond the year 2000. We use software, computer technology and other services internally developed and provided by third-party vendors that may fail due to the year 2000 phenomenon, and we may be unable to detect or assess the effect of any failure until well into the year 2000 and beyond. For example, we are dependent on the financial institutions involved in processing our customers' credit card payments for Internet services and a third party that hosts our servers. We are also dependent on telecommunications vendors to help maintain our network, suppliers to supply products to us and the United Parcel Service and other third-party carriers to deliver our products to customers.

Since inception, we have internally developed a significant portion of the systems for the operation of our Web site. These systems include the software used to provide our Web site's search, customer interaction, and transaction-processing and distribution functions, as well as monitoring and back-up capabilities. Based upon our assessment to date, we believe that our internally developed proprietary software is year 2000 compliant.

In an ongoing effort we have assessed the year 2000 readiness of our third-party supplied software, computer technology and other services, which include software for use in our accounting, database and security systems. As we have purchased software and hardware during 1999, we have sought assurances from each vendor that their software, computer technology and other services are year 2000 compliant. We have expensed amounts incurred in connection with year 2000 assessment since our inception through September 30, 1999. Such amounts have been under $50,000 in total. The failure of our software and computer systems or those of our third-party suppliers to be year 2000 compliant could have a material adverse effect on us.

The year 2000 readiness of the general infrastructure necessary to support our operations is difficult to assess. For example, we depend on the integrity and stability of the Internet to provide our services. We also depend on the year 2000 compliance of the computer systems and financial services used by consumers. Thus, the infrastructure necessary to support our operations consists of a network of computers and telecommunications systems located throughout the world and operated by numerous unrelated entities and individuals, none of which has the ability to control or manage the potential year 2000 issues that may impact the entire infrastructure. Our ability to assess the reliability of this infrastructure is limited and relies solely on generally available news reports, surveys and comparable industry data. Based on these sources, we believe most entities and individuals that rely significantly on the Internet are reviewing and attempting to remediate issues relating to year 2000 compliance, but it is not possible to predict whether these efforts will be successful in reducing or eliminating the potential negative impact of year 2000 issues. A significant disruption in the ability of consumers to reliably access the Internet or portions of it or to use their credit cards would have an adverse effect on demand for our products and services.

We believe the year 2000 compliance issue should not have a material impact on our operations and we have not developed a contingency plan. Specific factors which might cause the year 2000 issue to have a material adverse effect on our business include the availability and cost of trained personnel and the ability to recruit and retain them, as well as the ability to locate all system coding requiring correction. Base upon information available at this time, we believe that the cost of modifications, replacements and related testing will not have a material impact on our liquidity or results of operations.

We believe that our most reasonably likely worst case scenario related to year 2000 could include:

- disruption of our customers' ability to access our Web store;

- disruption of our ability to take orders from customers;

- disruption of our suppliers' ability to provide products to us;

- disruption of our ability to fulfill customers' orders; and - disruption of third-party carriers to ship products to our customers.

# *Business*

## *Overview*

We are a leading online retailer of pet products, integrating product sales with expert information on pets and their care. We are committed to serving pets and their owners with the best care possible through a broad product selection, expert information and superior service. We seek to address the entire pet products market, transcending the limited product selection of superstores, specialty stores and grocery stores. Our broad selection of approximately 12,000 SKUs is integrated with extensive pet-related information and resources designed to help consumers make informed purchasing decisions. For example, we provide information to help pet owners manage the life stages of their pet as well as

topical articles that address their pet care needs. We designed our Web store to provide our customers with a convenient, one-stop shopping experience that is organized to reflect how consumers think about shopping for their pets. Our Web store addresses the needs of many of the most popular pets, including dogs, cats, birds, fish, reptiles, ferrets, and other small pets. We provide quality customer service through our in-house distribution, fulfillment, customer service, and technology operations. Furthermore, we encourage participation in the pet community both through our Web store and through Pets.commitment, our charitable foundation that supports the role that pets and people play in each others' lives.

# *Industry Background*

## *The Growth of the Internet and Electronic Commerce*

The Internet has become an increasingly significant medium for communication, information exchange, and commerce. International Data Corporation estimates that there will be approximately 196 million online users worldwide at the end of 1999 and that this number will grow to approximately 399 million users by the end of 2002. Forrester Research estimates that online purchases made by consumers in the United States will grow from $20 billion in 1999 to $184 billion by 2004, representing a compound annual growth rate of 56%, and estimates that the total number of U.S. online consumers will grow from approximately 17 million in 1999 to 49 million in 2004, representing a compound annual growth rate of nearly 24%. We believe this increased usage is due to a number of factors, including a large installed base of personal computers, advances in the speed of personal computers and modems, easier and cheaper access to the Internet, improvements in network security, infrastructure and bandwidth, a broader range of online offerings, and growing consumer awareness of the benefits of online shopping.

## *The Pet Products Retail Industry*

The pet products industry is a large and growing market characterized by a loyal and emotion-driven customer base whose needs we believe are not adequately satisfied by traditional retail stores. According to the Pet Industry Joint Advisory Council, U.S. consumer spending on pet products and services grew at an annual rate of approximately 9% per year between 1993 and 1997 totaling approximately $23 billion at the end of 1997. Pets have become an increasingly important part of U.S. households, numbering over 235 million at the end of 1998, based on a survey conducted by Sloan Trends & Solutions, Inc. Today, more than 60% of U.S. households own a pet and 40% of those households own more than one, according to a recent American Pet Products Manufacturers Association study. In addition, according to Sloan Trends & Solutions, Inc., U.S. households spent on average $350 on their pets in 1998.

Pet owners generally exhibit strong emotional connections to their animals. For example, according to Sloan Trends & Solutions, Inc., over 80% of pet owners consider their pets to be members of the family and 67% buy their pets holiday gifts. In addition, over 80% of pet owners surveyed by the American Animal Hospital Association stated that in an emergency they would likely risk their life for their pet. Because of this strong human-animal bond, we believe pet owners, like parents, represent an attractive base of consumers who seek a wide variety of products and information for their pets which promote their pets' health, well being and happiness.

Store-based pet supply retailers have traditionally served the pet product market in the United States. These include superstore retailers such as Petco Animal Supplies, Inc. and PetsMart, Inc., grocery store retailers such as Kroger Company and Safeway, Inc., mass market retailers such as Wal Mart Stores, Inc. and Kmart Corporation, and smaller, independent specialty pet products stores.

While in the aggregate these channels provide consumers with a wide selection of pet related products, we believe traditional store-based retailers for pet products have the following limitations:

Lack of One-Stop Shopping. The pet products retail market is fragmented, generally requiring consumers to shop at multiple outlets to find everything they need for their pets. For example, superstore retailers, grocery stores and mass market retailers tend to carry a deep selection of well known brand name pet products from leading vendors, but have fewer specialty products. Specialty pet stores instead tend to carry a broader selection of specialty products from smaller vendors, but usually have a limited selection of the more well known brand name products. On a combined basis, specialty pet stores control the largest percentage of sales in the U.S. pet product retail market, having 20% of U.S. sales based on data published by the Pet Industry Joint Advisory Council in 1998. This lack of one-stop shopping also applies to other online retailers who have chosen to duplicate the traditional retail model in terms of selection and are offering a subset of a superstore product mix.

Limited Geographic Coverage. The few pet retailers who do tend to offer a broader selection of products either operate on a regional basis or only in metropolitan areas. This leaves a significant percentage of the U.S. population without easy access to all of the products they need for their pets. Opening additional stores would require substantial investments in real estate and inventory, as well as in trained personnel, for these chain stores. The high cost of opening and maintaining additional stores further limits the ability of retailers to serve geographic areas that are not densely populated.

Inconvenience of Store Design and Layout. We believe consumers value the opportunity to select items from a broad range of pet products that best fit their needs. However, the constraints of retail shelf space and store layouts limit traditional retailers' ability to meet many customers' needs, often dictating a limited product selection that appeals to the broadest number of consumers. Products are typically displayed by brand, category or packaging to maximize stocking efficiencies, especially for bulk products such as dog food, and to promote fast selling products. Further, because of large investments in inventory required to keep stores fully stocked, traditional pet retailers often have limited flexibility to adapt their merchandising strategies to meet changing consumer demand.

Limited, Inconsistent Information. Consumers buying pet products often seek information and expert advice to assist them in making purchase decisions. However, many traditional store-based retailers do not provide consumers with easy access to useful product information or readily available on-site experts who can provide assistance. In addition, even where on-site support is available, the quality of information and expertise may be inconsistent due to the challenges of hiring, training and maintaining knowledgeable sales staff. This limits the level of customer service available to consumers.

As a result of these factors, we believe that consumers typically find the pet product shopping experience to be both inconvenient and unpleasant. Shopping for pet products in retail stores can involve making trips to multiple stores, extended searching for desired products, waiting in line to make a purchase and carrying home heavy bags of pet food, litter or other bulk products.

## *The Pets.com Solution*

We are a leading online retailer of pet products integrating product sales with expert information on pets and their care. Our mission is to serve pets and their owners with the best care possible through broad product selection, expert information and superior service. We seek to address the entire pet products market, transcending the limited product selection of superstores, specialty stores and grocery stores. Our Web store tightly integrates broad product selection with highly relevant content, providing consumers with the pet-related information they need to make informed purchase decisions. Additionally, we provide information to help pet owners manage the life stages of their pet coupled with topical articles that address their pet care needs. We believe that our Web store provides customers with a superior one-stop shopping experience, with direct delivery to their doors.

We are distinguished in the online pet retail industry because of our in-house control over key aspects of our business. Our online design and editorial team is responsible for the consumer shopping experience, creation and delivery of pet information, and general usability of our Web store. Our technology group is responsible for the development and maintenance of our Web store and back-end transaction processing and fulfillment. Our merchandising team has more than 90 years of combined buying and merchandising experience and deep product knowledge which enables them to build and maintain close relationships with manufacturers and build our private label business. Our in-house distribution and fulfillment operation enables full control over the product supply process from product mix to customer shipments. Our customer service department manages the communication with customers. We believe our in-house control of these functions is an important strength that enhances our competitive position in the pet products industry.

We attract and retain consumers by emphasizing the following key attributes:

Extensive Product Selection Enables One-Stop-Shopping. We provide consumers with one-stop-shopping for their pet care needs, with direct delivery to their doors. Our broad selection addresses nearly the entire pet products market, transcending the limited product selection of superstores, specialty stores and grocery stores. We cater to the needs and interests of consumers who own dogs, cats, fish, birds, ferrets, reptiles, and other small pets. With only one distribution center, our SKU count

is currently equivalent to the number of SKUs available at the largest pet superstores, and by the middle of 2000 is projected to increase to roughly two times the SKUs available at these stores. Our online business model enables us to aggregate a diverse product selection that is not generally found in single retail outlets, respond more quickly to new product introductions than traditional retailers, and dynamically change our mix on a national basis to meet consumer needs and interests.

Expert Information and Professional Resources. Because of the emotional attachment consumers have toward their pets, they value extensive information from experts to give them confidence that they are giving their pets the best care possible. We offer this information to consumers in several different ways:

- Editorials. Our in-house staff of pet experts, veterinarians, an animal behavior specialist, and a pet attorney provide consumers with advice on a wide variety of animal topics. We offer an "Ask the Vet" column hosted by one of our veterinarians, in which answers are given to customer questions. In addition, multiple articles are posted weekly spanning seasonal topics, current events, health, nutrition, and behavior, among others.

- Periodicals. Our offline print publication, Pets.com, The Magazine For Pets and Their Humans, is designed to further establish Pets.com in the lives of consumers and their pets, and to introduce pet owners to the products and expert information available in our Web store. Our team contributes high quality, original content spanning lifestyle, health, behavioral, and product information. The first issue of the magazine was published in November 1999, and had a distribution of more than one million copies. We intend to publish this magazine on a bi-monthly basis.

- Professional Resources. Consumers can use our search tool to find a wide range of professional pet resources near where they live. These resources include veterinarians, hospitals and emergency care centers, kennels and boarding facilities, hotels accepting pets, and pet sitters, among others.

- Veterinary Relationships. We provide consumers with a comprehensive array of veterinary information through two exclusive strategic relationships. We have an exclusive strategic relationship with PetPlace.com which intends to launch a comprehensive, online educational library through its Web site in the first quarter of 2000 for pet owners and veterinarians covering pet illness and wellness. PetPlace.com will provide our customers with extensive resources through links to their Web site to help them increase the quality of healthcare for their pets. We also have a strategic alliance with the American Veterinary Medical Foundation which enables us to provide information about our products in their healthcare information video sent out bi-monthly to approximately 17,000 veterinarians, who can make this information available to consumers.

Superior Shopping Experience. We believe that we provide an intuitive, easy-to-use Web store, offering extensive product selection across the most popular pet types, supported by tightly integrated, relevant editorial and searchable resource information. We categorize and organize our products to reflect how consumers shop for their pets, allowing them to browse by pet type, category, product line and individual product. Our product presentation is supported by numerous high resolution photographs of products available for sale in our Web store. We offer search capabilities across all products and editorial content. Further convenience advantages of our Web store include:

- Continuous replenishment of food and litter through "Keep It Comin' " which allows customers to schedule ongoing deliveries of products;

- A gift center, allowing consumers to match gifts to pet lifestyles and personalities; and - Advanced personalization features, including the use of wish lists and address books.

Quality Customer Service. The typical online shopping experience begins with the search for products that meet specific needs, includes the online ordering process, and extends through product delivery and post-purchase support. We believe that the ability to accurately fulfill orders, ship products quickly to a customer's door, or efficiently handle customer inquiries is as important to customer satisfaction as product selection. We have invested significant resources to create our own fulfillment, distribution, and customer service functions rather than outsourcing these functions to a third party. The decision to build this operation in-house provides us with the ability to carry differentiated products, buy direct from manufacturers and improve product margins, reduce shipping and handling costs and provide customer satisfaction through better service.

Community. We encourage community participation both through our Web store and offline community efforts. Online consumers can participate in 60 different discussion groups covering various topics of interest across a range of pet types, and sign up to receive our online newsletter which is sent to consumers every two to three weeks. We offer specific forums for dogs, cats, fish, birds, reptiles, ferrets, horses, and small pets. Our online newsletter provides timely information, highlighting current articles and new products that are available at our Web store, and describes upcoming pet events. More than 200,000 consumers either receive our online newsletter or participate in our discussion groups each month. At the community level, we encourage participation through Pets.commitment, our charitable foundation that supports the role that pets and people play in each other's lives. Pets.commitment provides direct financial support and encourages volunteerism across animal shelters, animal therapy and service dog programs, and pet care and wellness organizations. Our intent is to contribute more than $1 million to these organizations by the end of 2000.

## *Business Strategy*

Our objective is to become one of the world's leading retailers of pet products. To achieve this objective, we intend to be the one-stop shop for pet products and the definitive source for pet information. Key elements of our business strategy include:

Build Enduring Brand Equity. We have marketed our Web store to consumers through a wide range of advertising and promotional activities. We intend to continue to leverage our offline and online marketing strategies to maximize customer awareness, attract consumers most likely to make online purchases, and enhance our brand recognition as follows:

- Advertising. We use television, radio, outdoor, and online advertising to build brand equity and create awareness. At the center of this campaign is our Pets.com sock puppet brand icon who we believe has already made an emotional connection with consumers. Media campaigns featuring this puppet communicate our key benefits of convenience, selection, and delivery.

- Online Marketing Relationships. We leverage our relationships with select online content providers and portals such as Blue Mountain Arts and Buena Vista Internet Group (Disney.com and Family.com) to attract consumers most likely to make online purchases.

- National Events and Local Marketing. We use national sponsorships and local market efforts to build brand awareness and expand our customer base. This includes participation in national events such as the 1999 Macy's Thanksgiving Day Parade and promotion of "Take Your Dog To Work Day." Local market activities such as SPCA events, dog walks, and adoption fairs reach pet owners in a pet-related context.

Offer Broadest Product Mix. We provide consumers with one-stop shopping for their pet care needs, with direct delivery to their doors. Our broad selection addresses nearly the entire pet products market, encompassing the selection of a superstore, specialty store and grocery store. We plan to grow from a SKU count of approximately 12,000 by year-end to more than 20,000 SKUs during 2000. We will continue to purchase products directly from manufacturers in order to optimize our product selection, enable a highly flexible product mix in response to new or fast moving items, strengthen our vendor relationships, customize promotions to specific consumer demographics and purchase patterns, easily test new items, and substantively improve our margins. We are currently working to broaden and diversify our product selection. For example, we will begin offering product in other pet-themed categories such as human apparel, calendars, picture frames and other home accessories by the first quarter of 2000. We also plan to introduce live fish during the first half of 2000 and equine-related products thereafter.

Establish Our Private Label Brands. We plan to introduce a full line of high quality, private label dog and cat food and cat litter in the first half of 2000, marketed under the Pets.complete brand name targeted to the premium buyer. Our private label business should provide further margin enhancement, continued growth of our brand, and enhanced consumer loyalty and repeat purchases. We intend to expand this product line in the second half of 2000 under the Pets.com brand name to include apparel, bowls, rawhide, chews, toys, and a range of other accessories. These private label products will only be available at our Web store and will further distinguish our product selection.

Provide Comprehensive and Relevant Content. We intend to be the definitive source of pet information. Our content is designed to address the broadest possible collection of pet types and a wide array of topics. We will increasingly deliver pet-related information in a variety of online and offline media forms, and in conjunction with a range of consumer and veterinary care partners. We will continue to encourage growing participation in a range of community forums, events, and newsletters.

Deliver Superior Customer Service and Promote Repeat Purchases. We intend to continue to deliver a superior online shopping experience that encourages repeat purchases, beginning with the initial order and continuing through product delivery and post-purchase support. To accomplish this, we intend to build features which allow greater personalization and targeting of our Web store to existing customers, and will continue to invest in people, technology and distribution facilities which will allow us to

continuously improve our customer service. This in-house competency enables us to distinguish our product selection from traditional and online retailers, realize better economics through greater margin control and reduced handling and shipping costs, and allows for better communication with customers.

Continue to Maintain and Expand our Relationship with Amazon.com. Amazon.com is currently our largest stockholder and is represented on our board of directors. Although Amazon.com has no contractual obligation to provide us with consulting advice or engage in joint marketing activities, as a result of this equity ownership in our business Amazon.com has historically provided us with a number of services that have enabled us to benefit from its extensive online retailing experience. We have been able to consult with our Amazon.com counterparts across a range of operational and strategic initiatives. We have engaged in a number of joint marketing activities including joint e-mails. In the future, we intend to work to maintain and expand this relationship to grow our business.

Expand Internationally. We intend to expand our business internationally in order to better serve pet owners and capitalize on a global market. We intend to complete the first step in this global expansion by taking an equity stake in Petspark.com, Ltd. a UK based online pet retailer that intends to offer pet owners a full range of pet-related services including a broad selection of pet products, expert information from veterinarians and animal behaviorists, and an online community of pet owners. In addition, Petspark.com, Ltd. will have the right to use our name in its marketing in the UK.

## *The Pets.com Experience*

We offer consumers instant online access to a wide array of products, expert information and professional resources. We believe that we provide a convenient, easy-to-use Web store, offering extensive product selection across the most popular pet types, supported by integrated, relevant editorial and searchable resource information. From our home page, consumers can access the shopping area, read pet care articles in "Today's Features," search our store for products or content, view the "Pet of the Day," access our professional resources, or participate in one of the community discussion groups. Our Web store is optimized for fast loading at a range of connection speeds. Key components of the Pets.com experience include:

Shopping at Pets.com. Our broad product selection offers products for many of the most popular pet types. We categorize and organize our products the way people shop for their pets, and support a highly visual shopping experience. Customers can shop at our online store as follows:

- Pet Type. Our product offering spans a wide selection of products for dogs, cats, fish, birds, reptiles, ferrets, and small pets like hamsters, rabbits, and guinea pigs. Our home page allows consumers to select pet type to help them narrow the choices that follow.

- Category. We provide consumers with the ability to browse categories based on the key attributes of that particular product category. For example, consumers shopping for dog food can browse by type of food, such as dry or canned, by the specific dog food brand, or by stage of their dog's life, such as puppy, adult or senior. These attributes differ by category and have been customized in our Web store to match

these shopping patterns. This non-duplicative navigational approach helps eliminate the problem of consumers becoming overwhelmed as they browse hundreds of items within a category to find the product that they need.

- Product Line. We enable consumers to browse as many as a dozen product lines from a single Web page. This browsing approach closely maps the physical retail experience and highly visual nature of shopping for pet products. In this category, a pet owner might know the color of the package or the picture on the front of the box, and then recall more specific information such as the brand name when they see the package.

- Individual Product. Our product pages feature large, high quality photos of each item, and allow customers to select flavor, color, size and quantity from a single Web page. This eliminates the need for consumers to navigate through multiple Web pages to specify the attributes of a particular item that they want to purchase. In addition, as consumers make their specific product selection, this same Web page displays product availability in real time.

- Checkout. We offer consumers a highly streamlined checkout experience requiring a minimal number of steps, only asking them for the information that is necessary to complete the transaction. The checkout area offers several convenient features such as the ability to create a personalized address book and then choose a specific address from the list by selecting it from a pull down menu.

In addition, we recently opened a gift center, which allows consumers to match gifts to pet lifestyles and personalities. For example, consumers can find gifts for "the urban pet," "the dog who has everything," or "the cat in vogue." This new area also features seasonal baskets, offering consumers gift ideas tailored to particular holidays and seasons of the year. Overall, the gift center capitalizes on our belief that consumers consider their pets to be members of the family, providing consumers with a fun, creative way to shop for their pets.

Editorial and Resource Information. We provide our customers with expert information and professional resources, tightly coupled with our product selection in order to support informed purchase decisions. The information supports various pet lifestyles from urban to rural, and the full spectrum of stages from the young pet to the aging pet. The timely, topical, relevant nature of this editorial information reinforces the emotional connection that pet owners have with their animals, which we believe will help build loyalty to Pets.com as consumers return to the store to read the latest news and information. We offer the following editorial and resource information to our customers:

- Online Articles. Our current editorial staff of in-house and freelance experts contributes 15-20 new articles per week which are posted in our Web store, spanning all pet types and a wide range of topical areas. Our experts include writers with extensive pet experience, veterinarians, an animal behaviorist, and a pet attorney. All articles contain a brief synopsis of the author's credentials in order to help consumers understand the area of expertise and qualifications of each of our writers. Our content includes product-specific information, basic pet information covering topics such as healthcare, nutrition, and behavior, and information based on seasonal topics and current events. We supplement

the breadth and depth of our original content with licensed content on topics such as breed profiles and basic pet care information. Where relevant, our stories contain product references and merchandising links to support decision-making.

- Resources. Consumers can use the search tool on our Web store to find a wide range of pet resources specific to the area in which they live. This resources include veterinarians, hospitals and emergency care clinics, kennels and boarding facilities, hotels that accept pets, and pet sitters, among others.

- Pets.com, The Magazine For Pets and Their Humans. We are currently the only online pet retailer publishing a print magazine, which is designed to broaden awareness of Pets.com, drive purchase of products sold through our Web store, and increase current customer loyalty. Many pet owners will be introduced to our store through this magazine, which was published for the first time in November 1999, and distributed to approximately 760,000 qualified pet owning households and nearly 300,000 copies to veterinary offices, shelters, and pet sitter organizations. We also distribute the magazine through our in-box product shipments to customers. We intend to publish new issues of the magazine bi-monthly.

## *Merchandising and Product Selection*

Merchandising. We have assembled an in-house merchandising team with pet industry expertise spanning product design, buying, import sourcing, and retail experience. This expertise gives us several key advantages. We use our category knowledge to source a broad assortment of products that encompasses the selection of a superstore, specialty store and grocery store. We leverage our vendor relationships to buy direct and realize better pricing, rapidly bring new products to market, capitalize on promotional opportunities, and easily test new items on a national basis. We currently offer a majority of the well known brands in the pet industry such as Science Diet, IAMS, Pedigree and Eukanuba, and other well-known brands such as Alpo, FreshStep, Friskies and Hartz. We also offer our premium private label brand that includes Pets.complete food and litter and Pets.com supplies and accessories. Over time, we anticipate that 10-20% of our revenues will come from our private label products.

Product Offering. Our product offering provides customers with a breadth and depth of selection across the most popular pet types and product categories as follows:

## *Dogs Cats Fish Birds*

| | | | |
|---|---|---|---|
| Apparel | Beds | Aeration & Bubblers | Books & Videos |
| Beds | Books | Aquarium & Kits | Cage Accessories |
| Behavior Modification | Bowls | Books & Videos | Food |
| Bones | Cages & Accessories | Bowls | Hand Feeding |
| Books | Calendars | Breeding Supplies | Healthcare & Remedies |
| Bowls & Supplies | Carriers | Cleaning Equipment | Nesting Supplies |
| Calendars | Catnip & Cat Grass | Decor | Toys |
| Carriers | Collars | Filtration | Treats |
| Chews | Doors & Barriers | Food & Accessories | Wild Bird & Wildlife |
| | Feeders & Waterers | Health Care | FERRETS |

Collars
Containment
Doors & Barriers
Ears, Hooves, Etc.
Feeders & Waterers
Flea & Pest Control
Food
Food Containers
Grooming
Hair Lifters & Rollers
Harnesses
Health Care & Remedies
Holiday
Houses & Accessories
I.D. Tags
Leashes
New Puppy
Outdoor Clean-Up
Rawhide
Repellents
Safety & First Aid
Stain Odor
Tie-Outs
Toys
Training
Treats & Biscuits
Videos & CDs
Vitamins & Supplements

Flea & Pest Control
Food
Furniture
Grooming
Harnesses
Health Care & Remedies
Holiday
I.D. Tags & Belts
Leashes
Litter
Litter Box Supplies
Litter Boxes
New Kitten
Repellents
Scratchers
Stain & Odor
Toys
Training
Treats
Vitamins & Supplements

Heaters
Lighting
Live Plan Supplies
Nets
Pond
Saltwater Supplies
Thermometers
Valves & Tubing
Water Test Kits
Water Treatments
REPTILES
Books & Videos
Bowls & Waterers
Decor
Food & Treats
Habitats
Health Care
Heating
Humidifiers
Leashes
Lighting
Substrate
Thermometers

Apparel
Food & Treats
Grooming
Habitats
Hammocks & Beds
Health Care
Leashes
Litter
Litter Pans
Toys
SMALL PETS
Bedding
Books & Videos
Cage Accessories
Cage Kits
Carriers
Collars & Leashes
Exercise
Feeding Supplies
Food
Grooming
Habitats
Health Care
Miscellaneous
Treats & Chews

Product Sourcing. As of November 30, 1999, we purchased our products from a network of approximately 200 manufacturers. For the period from inception through September 30, 1999, approximately 80% of our total sales were from this network of manufacturers. In addition, we anticipate adding well over 100 new direct relationships in the first half of 2000 as we expand our product selection.

## *Veterinary Care and Services*

The American Pet Products Manufacturers Association cites that seven out of ten dog and cat owners rely on veterinarians when they need information about their pet. Given this high degree of reliance on veterinary expertise, we provide consumers with access to extensive veterinary care information. In parallel, we reach veterinarians with the most up-to-date research and information in order to help them better serve pet owners. We accomplish these objectives in several ways: by providing a wide variety of articles written by veterinarians; by allowing consumers to participate in our "Ask the Vet" column; and, by entering into relationships with accredited veterinary care organizations that provide consumers with in-depth information on pet illness and wellness, and that offer veterinarians access to the most current research and information on pet healthcare. A description of our strategic veterinary care relationships follows. 34 PetPlace.com, Inc. We have made an equity investment in PetPlace.com and entered into a three year exclusive marketing agreement which includes mutual revenue sharing and new customer bounties which are paid for every new customer referred from one site to another. PetPlace.com intends to launch an online comprehensive, interactive, educational library through its Web site in the first quarter of 2000 for pet owners and veterinarians covering illness and wellness.

Consumers will be able to search for relevant information on the site before they visit their veterinarian and after the pet's illness is diagnosed. Consumers will also be able to create a personal history of their pet, which might include recommendations on food, grooming, worms, or flea control. PetPlace.com is distinguished by its exclusive relationship with Angell Memorial Animal Hospital, one of the leading veterinary specialty hospitals, whose specialists provide content for this site and online consultations for consumers.

We intend to provide our customers with in-depth veterinary care information, generate highly qualified customer leads, encourage repeat visits to our Web store, and build our brand. Our Web store is fully integrated with PetPlace.com in a number of ways: PetPlace.com consumers will be able to navigate directly from PetPlace.com articles to relevant products for purchase at our Web store; consumers who ask our veterinarians questions will be able to receive answers to the highly specialized healthcare issues from PetPlace.com; and consumers will be able to have direct access to extensive veterinary resources available on PetPlace.com.

American Veterinary Medical Foundation. The American Veterinary Medical Foundation is a renowned professional association of over 60,000 veterinarians. Our strategic relationship with the American Veterinary Medical Foundation is a three year exclusive marketing agreement that we believe provides us with enhanced credibility. We have agreed to provide financial support in an amount of approximately $500,000 to the American Veterinary Medical Foundation for key activities such as "ClientLink," a video sent out by American Veterinary Medical Foundation every two months to 17,000 veterinarians that provides up-to-date news and pet healthcare information. In return for this support, our Web store will receive bi-monthly coverage of products, services, and key initiatives, such as the launch of PetPlace.com in "ClientLink" beginning in January 2000, and we will have the right to use the American Veterinary Medical Foundation logo on our home page.

## *Marketing and Promotions*

Our marketing strategy is designed to attract customers most likely to shop online, convert browsers to buyers, meet or exceed customer expectations, drive loyalty and repeat purchases, build enduring brand equity, and reinforce the human-animal bond. In order to implement this strategy, we execute an integrated marketing campaign that includes the following:

- Advertising. Our advertising is designed to build brand equity, create awareness, and generate initial purchase of products sold through our Web store. The campaign features the Pets.com sock puppet, who we believe has become popular with many consumers, and is a strategic icon of our brand. In this advertising, our sock puppet is a roving advocate for the brand, and has a playful, enthusiastic, funny, and caring personality. In our ads, he endears himself to both animals and their owners as he strives to make sure they get the products that they need. We use a mix of broadcast media including national network television, local radio in the top markets with online shoppers, outdoor advertising, online banners, text links, and e-mail newsletters.

- Amazon.com Joint Marketing. We have implemented joint marketing programs with Amazon.com. To date, this includes joint e-mails. In addition, links to our Web page rotate on Amazon.com's home page and on other book category pages, consistent with their other marketing arrangements. In all of these marketing programs, Amazon.com receives a referral fee for delivering new customers to our Web store.

- National Events and Local Marketing. Our national sponsorships are designed to build brand awareness and expand our customer base. A balloon float of our Pets.com sock puppet was featured in the 1999 Macy's Thanksgiving Day Parade, and was viewed on television by approximately 52 million people. We own the trademark to "Take Your Dog to Work Day," and will be launching 35 a national publicity campaign in 2000 which includes a video news release and a "Do It Yourself Kit" that helps companies structure their own event. We are the presenting sponsor of "Dog Day Afternoon," an outdoor festival for dogs and their owners organized by Design Industries Foundation Fighting AIDS. Our local marketing activities are designed to deliver the Pets.com message in a pet-related context at the community level. This includes local market efforts such as SPCA events and dog fashion shows, and grassroots activities including dog walks and adoption fairs in high Internet penetration markets.

- Strategic Online Marketing Relationships. We have identified a select group of online companies who we believe attract buyers more likely to shop for pet products online. We are the exclusive online pet retailer for Blue Mountain Arts, and have created special "pet holiday cards" that are offered to consumers at Bluemountain.com. Our advertising relationship with Buena Vista Internet Group (Disney.com and Family.com) allows us to be the exclusive online pet retailer for the animal channel on Disney.com and Family.com. We are the exclusive online pet retailer for PlanetOut. These agreements expire in September 2000, April 2000 and August 2000, respectively. We have also entered a non-exclusive relationship with AOL on their Shopping Channel. In addition, we have an exclusive relationship with Pet Sitters International, Inc. until December 2002, under which we list their approximately 3,000 pet sitters in the resources area of our Web store in exchange for sales commissions. Furthermore, our Associates Program, based on Be Free's associate program technology, encourages other Web sites to link to our store and earn sales commissions. Associates can earn referral fees on all Pets.com purchases made from the links on their site, and earn a bounty for each new customer.

- Promotions. We selectively utilize promotional offers to further our brand building efforts. This includes promotions such as on-site merchandising of product discounts and pet-themed specials, the "Keep It Comin' " food subscription program, trial offers at local events such as organized dog walks, and coupon offers in our online newsletter and in Pets.com, The Magazine for Pets and Their Humans.

- Philanthropic Marketing. Our philanthropic marketing effort is designed to deepen our relationship with pet owners and expand our customer base. Pets.commitment is our charitable foundation, which provides direct financial support and encourages volunteerism across animal shelters, animal therapy and service dog programs, and pet care and wellness organizations. Our intent is to contribute more than $1 million to these organizations by the end of 2000. We contribute to organizations where "people help animals," such as SPCAs and humane organizations across the country including Best

Friends Animal Sanctuary in Utah. We also contribute to organizations where "animals help people," including Design Industries Foundation Fighting Aids, Canine Assistants, and The North American Disabled Riders Association.

- Public Relations. We utilize public relations to drive coverage across a wide array of high profile outlets, spanning television, radio, magazines, and newspapers.

## *Fulfillment and Distribution*

We have built an in-house fulfillment and distribution operation which is used to manage the entire supply chain beginning with placement of the customer's order, and continuing through order processing, fulfillment, and shipment of product to the customer. In addition, we can improve our economics through lower shipping and handling costs, and a higher margin product mix availability.

We currently fulfill all customer orders from our new 143,232 square foot distribution center in Union City, California and a 84,000 square foot satellite facility in Hayward, California. We currently receive goods from our suppliers at the distribution center into an automated system which assigns bin and storage locations. The inventory system is linked to the Web store which automatically updates product availability. A team of individuals using the same automated system picks products to fill orders which are then packed on location and loaded onto UPS, United States Postal Service or other shipping trucks for distribution to consumers in all 50 states. We are committed to shipping a high volume of accurate orders, efficiently and effectively.

We believe our expertise in fulfillment and distribution, developed as the result of our experience with the original Union City distribution center, enables us to expand rapidly to our second distribution center. By adding regional distribution centers, we can significantly increase our SKU count, improve ship time to customers, and reduce shipping costs. We are in the process of establishing a second distribution center in Greenwood, Indiana. This 292,500 square foot warehouse is scheduled to open in the first half of 2000, and is intended to mirror the SKUs carried in the Union City distribution center. We believe that two distribution centers can likely support our growth into 2001 based on anticipated levels of demand for our products.

## *Customer Service*

We believe that a high level of customer service and support is critical to retaining and expanding our customer base. Our in-house customer service team is available via phone from 6 a.m. to 8 p.m. Pacific time, Monday to Friday, and can also be reached by e-mail or fax. We currently have 90 full-time employees in customer service as of November 30, 1999. This team is central to our ability to deliver a superior customer experience and strives to make a personal connection with each consumer.

We view Amazon.com's customer service performance to be the standard in the industry and we seek to emulate their customer service approach. We seek to exceed customer expectations. We provide proactive customer service which includes e-mail order confirmation, e-mail ship confirmation with

tracking numbers, notifying customers of out-of-stock situations, and for those orders, updating customers on order status on a frequent basis. We increase staff to handle peak periods and train customer service representatives across departments to help them better understand the business.

We are dedicated to customer satisfaction. One of the ways that we deliver on this commitment is through our product, customer service, privacy, and security guarantees. Our product guarantee offers consumers a 30-day refund if their shipment is not satisfactory. Our customer service guarantee commits to a one business day response time for all inquiries. Our privacy guarantee commits that Pets.com will not sell, trade or rent personal information to other companies, and communicates that this information is used exclusively to process orders and to provide a more personalized shopping experience. Our security guarantee ensures protection of personal information and compensation to consumers for the amount of their liability, up to $50, in the unlikely event of unauthorized interception and use of their credit card.

## *Technology and Network Operations*

We have implemented a broad array of services and systems for site management, searching, customer interaction, transaction processing, and fulfillment. We designed our system for scalability, reliability, and performance, using a set of software applications for:

- Displaying merchandise in a logical, customer-friendly way;

- Accepting and verifying orders;

- Processing credit card orders;

- Organizing, placing, and managing customer orders;

- Notifying and updating customers of order status;

- Managing shipment of products; and - Managing community forums and the communication of pet and pet care information.

These services and systems use a combination of our own proprietary technologies and commercially available, licensed technologies. We selected BroadVision as our e-commerce platform, and have a non-exclusive license to use their commerce application, which has been customized by our internal engineers for the Pets.com shopping experience. This robust commerce application is integrated with our Quality Software Systems, Inc. warehouse management system, enabling a fully automated order fulfillment process. We realize many benefits from the integration of these front-end and back-end systems, including the ability to track customer orders through the entire supply chain in real-time, make rapid changes to processes such as a change in shipping policy, or efficiently expand our infrastructure to support the addition of a new distribution center.

It is our policy that our vendors meet the requirement of providing technical support 24 hours a day, 7 days a week, 365 days a year. Our Sun Microsystems, Inc. servers are Unix-based, and our software platform and architecture is integrated with an Oracle Corporation database system. Our Internet

servers use Verisign, Inc. digital certificates to help conduct secure communications and transactions. Our production system is co-located at Exodus Communications, Inc. in Santa Clara, California, and provides 24-hour engineering and monitoring support. We anticipate adding an additional co-location facility in the eastern United States in stages over the course of 2000 for redundancy and performance purposes.

We address the goals of scalability, reliability and performance in a number of ways. We have replicated key components of our production system in-house in order to perform load testing that enables us to simulate our Web store and better support peak shopping periods. We aim to have fast download times and make use of caching and load balancing at the Web server and application level for optimal performance. We are implementing vertical hardware partitioning in early 2000, enabling us to do significant work on the Web store without having to take it down for maintenance.

We elected to build an in-house development and operations team augmented by outside consultants to enable faster response to changing market conditions. We only outsource development work that is considered to be non-strategic. Our in-house development team builds out new features, focusing on the software and functionality that is unique to our business. Our in-house operations team ensures that our Web store is up and running 24 hours a day, seven days a week. We incurred $3.8 million in product development expenses in the period from inception to September 30, 1999. We anticipate that we will continue to devote significant resources to product development in the future as we add new features and functionality to our Web store. Long term, we believe our in-house capability will allow us to manage strategic initiatives such as the creation of a data warehouse enabling our merchandising team to better understand our customers, and then use this information to modify our product mix and enhance our margins.

## *Competition*

The online commerce market is new, rapidly evolving and intensely competitive. We expect competition to intensify in the future. In particular, the pet products, information and services market is intensely competitive and are also highly fragmented, with no clear dominant leader in any of our market segments. Our competitors can be divided into several groups: online stores that specialize in pet products, such as Petopia.com, Inc., which is owned in part by Petco Animal Supplies, Inc., PetsMart.com, Inc., which is owned in part by PetsMart, Inc., and Petstore.com, Inc.; superstore retailers of pet products such as Petco Animal Supplies, Inc., and PetsMart, Inc.; specialty pet stores; mass market retailers such as Wal Mart Stores, Inc., Kmart Corporation and Target Stores, Inc.; supermarkets; warehouse clubs such as Costco Companies, Inc.; mail order suppliers of pet products; and pet supply departments at major department stores. Each of these competitors operates within one or more of the pet products, information and services segments.

We believe that the following are principal competitive factors in our market:

- brand recognition;

- product selection;

- quality of Web store content;

- reliability and speed of order shipment;

- streamlined shopping experience;

- customer service;

- speed and accessibility of Web store;

- personalized service;

- convenience; and

- price.

Many of our current and potential traditional store-based and online competitors have longer operating histories, larger customer or user bases, greater brand recognition and significantly greater financial, marketing and other resources than we do. Many of these current and potential competitors can devote substantially more resources to Web site and systems development than we can. In addition, larger, more well-established and financed entities may acquire, invest in or form joint ventures with online competitors or pet supply retailers as the use of the Internet and other online services increases.

Some of our competitors may be able to secure products from vendors on more favorable terms, fulfill customer orders more efficiently and adopt more aggressive pricing or inventory availability policies than we can. Traditional store-based retailers also enable customers to see and feel products in a manner that is not possible over the Internet. Some of our competitors such as Petco Animal Supplies, Inc. and PetsMart, Inc. have significantly greater experience than we do in selling pet supplies and pet care products.

## *Relationship with Amazon.com*

We have a strategic relationship with Amazon.com whereby Amazon.com has provided free consulting services relating to the operation of our business and has promoted our Web store. Amazon.com is our largest stockholder and has invested a total of approximately $57.8 million to date in Pets.com. Randy Tinsley, Amazon.com's Vice President of Corporate Development, is a member of our Board of Directors. See "Executive Officers and Directors", "Related Party Transactions" and "Principal Stockholders" for a further discussion of Amazon.com's equity ownership of us. As part of our relationship, in April 1999 we entered into an advertising agreement with Amazon.com whereby Amazon.com provides us with online promotions mutually agreed upon, such as e-mails about Pets.com, and one or more links from different locations on its Web site to our Web store, consistent with Amazon.com's other marketing agreements. Under our agreement, the content, placement, timing, and even the extent of most of these online promotions are determined at Amazon.com's discretion and can be terminated by Amazon.com at any time. Under the agreement, we are obligated to maintain a link on our home page to Amazon.com's Web site, and pay Amazon.com a referral fee for each new

customer referred from Amazon.com's Web site, reduced by new customers we refer from our Web store to Amazon.com. Unless terminated earlier for breach by the non-breach party, the agreement will expire in October 2000.

In addition to this formal agreement, Amazon.com has provided free consulting advice to our management team upon request regarding brand building efforts, Web store design, product merchandising, fulfillment and distribution, and a variety of other operational and strategic issues that are important to our business. The existence of this relationship with Amazon.com, Amazon.com's stockholder position in Pets.com and our advertising agreement with Amazon.com, has also enabled us to attract the attention of potential corporate partners and to enter into alliances with corporate partners on favorable terms. While our relationship with Amazon.com has received significant media attention, Amazon.com is not obligated to provide any of this advice and support.

## *Other Strategic Relationships*

We continually seek to form strategic relationships to increase our access to online customers, build brand recognition, and expand our online presence. Because of our relationship with Amazon.com, we believe that we can execute fewer, more focused, and less costly ventures to accomplish our objectives over the long-term. In addition to our relationship with Amazon.com, we have established the following relationships:

General Internet Portal Sites. These companies provide an aggregated audience of Internet users to whom we market our products and services. These marketing activities drive new customers to our Web site and extend our brand. These companies are America Online, Inc., Lycos, Inc., Buena Vista Internet Group (Disney.com and Family.com), Xoom.com, Inc., PlanetOut Corporation and Snap! L.L.C.

Pet Related Internet Sites. To ensure the strength of our brand among pet owners we have established exclusive relationships with Petplace.com, Inc. and Pet Sitters International, Inc., whose pet oriented Internet sites attract large audiences of pet owners. In addition, through our relationship with Be Free, our Associates Program encourages other Web sites to link to our store and earn sales commissions.

Content Providers. To ensure that our site attracts and retains a large audience of pet product consumers we have established relationships with various content providers relevant to pet owners of all types. These content providers are Blue Mountain Arts, Dawbert Press, Inc. and IDG Books Worldwide, Inc.

Pets.com Sponsorships. Our relationships with these organizations not only increases our brand awareness, but also increases the goodwill associated with our brand among pet owners and the general population. These organizations are American Veterinary Medical Foundation, Best Friends Animal Sanctuary, Design Industries Foundation Fighting AIDS and NADRA Productions.

International Relationships. We plan to make an equity investment in Petspark.com, a UK-based online pet retailer that intends to offer pet owners a full range of pet-related services. This relationship will include consultation, marketing support, and use of the Pets.com name. This agreement should allow us to expand our business internationally in order to better serve pet owners and capitalize on the global market.

## *Intellectual Property*

We regard the protection of our copyrights, service marks, trademarks, trade dress and trade secrets as critical to our future success and rely on a combination of copyright, trademark, service mark and trade secret laws and contractual restrictions to establish and protect our proprietary rights in products and services. We have entered into confidentiality and invention assignment agreements with our employees and contractors, and nondisclosure agreements with our suppliers and strategic partners to limit access to and disclosure of our proprietary information. We cannot be certain that these contractual arrangements or the other steps taken by us to protect our intellectual property will prevent misappropriation of our technology. We have licensed in the past, and expect that we may license in the future, certain of our proprietary rights, such as trademarks or copyrighted material, to third parties. While we attempt to ensure that the quality of the Pets.com products brand is maintained by such licensees, we cannot assure that such licensees will not take actions that might hurt the value of our proprietary rights or reputation. We also rely on technologies that we license from third parties, such as BroadVision, Inc., Oracle Corporation, Netscape Communications Corporation (AOL), Quality Software Systems, Inc., Sun Microsystems, and Compaq Computer Corporation, the suppliers of key e-commerce software, database technology, operating system software, and specific hardware components for our service. We cannot be certain that these third-party technology licenses will continue to be available to us on commercially reasonable terms. The loss of such technology could require us to obtain substitute technology of lower quality or performance standards or at greater cost, which could harm our business.

We have filed applications for the registration of Pets.com(TM), the Pets.com logo, Because Pets Can't Drive(TM), Keep It Comin'(TM), More Products Than a Superstore Delivers(TM), People Helping Animals, Animals Helping People(TM), and Pets.commitment(TM) in the U.S. and in some other countries, although we 40 have not secured registration of any of our marks to date. We have been granted the right to use Pets.complete(TM) from a third party. We may be unable to secure these registered marks. It is also possible that our competitors or others will use marks similar to ours, which could impede our ability to build brand identity and lead to customer confusion. In addition, there could be potential trademark or trademark infringement claims brought by owners of other registered trademarks or trademarks that incorporate variations of the term "Pets.com." Any claims or customer confusion related to our trademark, or our failure to obtain trademark registration, would negatively affect our business. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the U.S., and effective copyright, trademark and trade secret

protection may not be available in such jurisdictions. Our efforts to protect our intellectual property rights may not prevent misappropriation of our content. Our failure or inability to protect our proprietary rights could substantially harm our business.

## *Government Regulation*

We are not currently subject to direct federal, state or local regulation other than regulations applicable to businesses generally or directly applicable to retailing or electronic commerce. However, as the Internet becomes increasingly popular, it is possible that a number of laws and regulations may be adopted with respect to the Internet. These laws may cover issues such as user privacy, freedom of expression, pricing, content and quality of products and services, taxation, advertising, intellectual property rights and information security. Furthermore, the growth of electronic commerce may prompt calls for more stringent consumer protection laws. Several states have proposed legislation to limit the uses of personal user information gathered online or require online services to establish privacy policies. The Federal Trade Commission has also initiated action against at least one online service regarding the manner in which personal information is collected from users and provided to third parties and has proposed regulations restricting the collection and use of information from minors online. We do not currently provide individual personal information regarding our users to third parties and we currently do not identify registered users by age. However, the adoption of additional privacy or consumer protection laws could create uncertainty in Web usage and reduce the demand for our products and services or require us to redesign our web site.

We are not certain how our business may be affected by the application of existing laws governing issues such as property ownership, copyrights, encryption and other intellectual property issues, taxation, libel, obscenity, qualification to do business and export or import matters. The vast majority of these laws were adopted prior to the advent of the Internet. As a result, they do not contemplate or address the unique issues of the Internet and related technologies. Changes in laws intended to address these issues could create uncertainty in the Internet marketplace. This uncertainty could reduce demand for our services or increase the cost of doing business as a result of litigation costs or increased service delivery costs.

In addition to regulations applicable to businesses generally, we are regulated by federal, state or local governmental agencies with respect to the shipment of pet food, live animals and pet products, advice relating to animal care, and other matters. We currently seek to rely upon our suppliers to meet the various regulatory and other legal requirements applicable to products and services supplied by them to us. However, we are unable to verify that they have in the past, or will in the future, always do so, or that their actions are adequate or sufficient to satisfy all governmental requirements that may be applicable to these sales. We would be fined or exposed to civil or criminal liability, and we could receive potential negative publicity, if these requirements have not been fully met by our suppliers or by us directly.

## *Legal Proceedings*

From time to time, we may be involved in litigation relating to claims arising out of our ordinary course of business. On September 21, 1999 Biolink L.L.C. dba ERI International sued us in Los Angeles County Superior Court for breach of contract, anticipatory breach of contract, breach of the implied covenant of good faith and fair dealing, and fraud arising out of a contract entered into for the shipment of live animals, including fish and reptiles. ERI International has stated four causes of action, three seeking 41 damages each in an amount in excess of $2,000,000 and one seeking damages in an amount in excess of $500,000. We have answered and asserted affirmative defenses to their complaint. No trial date has been set and discovery has not yet commenced. We believe we have meritorious defenses against these claims and intend to vigorously defend against them.

## *Employees*

As of November 30, 1999, we had 260 employees. None of our employees is represented by a labor union. We have not experienced any work stoppages and consider our employee relations to be good.

## *Facilities*

Our principal executive offices are located in San Francisco, California, where we lease approximately 17,000 square feet under a lease and sublease that expire in June 2002, with an option to extend until 2004. We believe that our current executive office space is adequate to meet our needs through the end of March 2000, at which time we plan to relocate to new executive offices in San Francisco, California, where we have arranged to lease approximately 40,410 square feet under a lease that expires no earlier than April 2010. For our Northern California distribution center and satellite facility, we lease approximately 143,232 square feet in Union City, California under a sublease that expires in August 2004 and 84,000 square feet in Hayward, California under a lease that expires in November 2004. In addition, we lease approximately 15,000 square feet in San Francisco, California for additional warehouse and distribution purposes under a lease that continues on a month-to-month basis after December 31, 1999. For our second distribution center, we have entered into a lease for approximately 292,500 square feet in Greenwood, Indiana, that expires in December 2005.

# *Management*

## *Executive Officers and Directors*

Our executive officers and directors and their ages as of December 31, 1999 are as follows:

# *Name Age Position*

| | | |
|---|---|---|
| Julia L. Wainwright | 42 | Chairman of the Board of Directors and Chief Executive Officer |
| Christopher E. Deyo | 40 | President |
| Paul G. Manca | 41 | Chief Financial Officer |
| John R. Benjamin | 49 | Vice President of Merchandising |
| John M. Hollon | 44 | Vice President of Editorial |
| John A. Hommeyer | 33 | Vice President of Marketing |
| Diane R. Hourany | 45 | Vice President of Customer Service |
| Sue Ann Latterman, V.M.D | 42 | Vice President of Strategic Alliances |
| Ralph E. Lewis | 53 | Vice President of Distribution and Logistics |
| Paul W. Melmon | 38 | Vice President of Engineering |
| Kathryn C. Ringewald | 39 | Vice President of Human Resources |
| John B. Balousek(1) | 54 | Director |
| Matthew T. Cowan | 27 | Director |
| John R. Hummer(2) | 51 | Director |
| Randolph J. Tinsley(1)(2) | 39 | Director |

(1) Member of Audit Committee (2) Member of Compensation Committee Julia L. Wainwright has served as our Chief Executive Officer and one of our directors since March 1999 and Chairman of the Board since December 1999. From March 1998 to February 1999, she served as Chief Executive Officer of Reel.com, Inc. From May 1997 to February 1998, Ms. Wainwright was independently researching e-commerce opportunities. From December 1996 to April 1997, she served as Chief Executive Officer of Berkeley Systems, Incorporated, as President from August 1995 to November 1996 and as Vice President of Sales and Marketing from January 1995 to August 1995. From June 1994 to December 1994, she served as Vice President of Marketing of Mindscape, Inc. From October 1993 to June 1994, she was a partner in Corporate Development Partners, a private venture capital firm. From August 1991 to October 1993, she served as Vice President of International for Spinnaker Software, Inc. From October 1988 to August 1991, she worked for Power Up Software Corporation in several positions, finishing as Vice President of International. From January 1982 to October 1988, she served in various management positions at Software Publishing, Inc. and from January 1980 to December 1982, she worked in brand management at The Clorox Company. Ms. Wainwright holds a B.S. from Purdue University.

Christopher E. Deyo has served as our President since April 1999. From July 1998 to March 1999, he served as President of Reel.com, Inc. He served as General Manager of Berkeley Systems, Incorporated from March 1997 to June 1998 and as Vice President of Marketing from September 1996 to February 1997. From May 1995 to August 1996, Mr. Deyo served as Vice President of Marketing of Microprose, Inc. From January 1995 to April 1995, Mr. Deyo was independently researching technology opportunities. From September 1987 to December 1994, he worked for Kransco Group Companies in several positions, finishing as Vice President of Marketing. Mr. Deyo co-founded Video Edge, Inc. where he served in various capacities from May 1986 to August 1987. From August 1983 to April 1986, he worked in brand management at The Procter & Gamble Company. Mr. Deyo holds a B.S. and an M.B.A. from Syracuse University.

Paul G. Manca has served as our Chief Financial Officer since September 1999. From May 1995 to September 1999, he served as Chief Financial Officer of CellNet Data Systems, Inc. From February 1987 to May 1995, he worked for BZW/Barclays, an investment bank, finishing as Managing Director

and Group Head of the Communications Group within Corporate Finance. Mr. Manca holds a B.A. from the University of California at Berkeley and an M.B.A. from Golden Gate University.

John R. Benjamin has served as our Vice President of Merchandising since May 1999. From September 1990 to April 1999, Mr. Benjamin worked for Petco Animal Supplies, Inc. in several positions, finishing as Director of Imports and Global Sourcing. From December 1989 to August 1990, he served as the National Sales Manager for Suunto, USA and from September 1984 to December 1989, he worked as a buyer for Oshman's Sporting Goods, Inc. From September 1971 to July 1984, Mr. Benjamin worked for Fedco Membership Department Stores, Inc., in several positions finishing as a store manager.

John M. Hollon has served as our Vice President of Editorial since April 1999 and as Editor and Publisher of Pets.com, The Magazine for Pets and Their Humans since September 1999. From November 1996 to April 1999, he served as Group Editorial Director of Fancy Publications, Inc. Mr. Hollon also worked as a newspaper editor for 19 years, most recently with Gannett Co., Inc., as Editor of The Great Falls Tribune in Montana and as Executive Editor of The Honolulu Advertiser in Hawaii. Mr. Hollon holds a B.A. from California State University at Long Beach.

John A. Hommeyer, Jr. has served as our Vice President of Marketing since May 1999. From August 1988 to April 1999, he worked at The Procter & Gamble Company in several U.S. and international positions, finishing as Marketing Director of Global Baby Care. Mr. Hommeyer holds an A.B. from Dartmouth College.

Diane R. Hourany has served as our Vice President of Customer Service since December 1999 and as Vice President of Operations from April 1999 to November 1999. From June 1998 to April 1999, Ms. Hourany served as Vice President of Operations of Reel.com, Inc. From February 1994 to May 1998, she served as General Manager of Catalog Fulfillment for Bullock & Jones, a subsidiary of Saks Fifth Avenue, Inc. and from September 1987 to January 1994, Ms. Hourany served as Manager of Telemarketing & Customer Services of Power Up Software Corporation. Ms. Hourany holds an A.A. from Diablo Valley College.

Sue Ann Latterman, V.M.D. has served as our Vice President of Strategic Alliances since November 1999 and as Vice President of Business Development from May 1999 to October 1999. From August 1998 to April 1999, she served as Chief Operating Officer of CrossCart, Inc. From March 1996 to July 1998, Dr. Latterman worked as a consultant to the medical device industry and from October 1994 to March 1996, she served as Vice President of Clinical Affairs of Percusurge, Inc. From July 1993 to September 1994, she worked as an associate at Mohr Davidow Ventures, a private venture capital firm, and from January 1993 to June 1993, as a consultant to the biotechnology industry. From November 1990 to December 1992, she served as Manager of Market Research of Hybritech Incorporated. From July 1989 to August 1990, Dr. Latterman attended business school and from May 1985 to June 1989, she practiced veterinary medicine in Pittsburgh, Pennsylvania and Ringoes, New Jersey. Dr. Latterman holds a B.A. and V.M.D. from the University of Pennsylvania and an M.B.A. from the University of Pittsburgh.

Ralph E. Lewis has served as our Vice President of Distribution and Logistics since November 1999. From January 1998 to October 1999, he served as Vice President of Operations for Office Depot, Inc. From June 1995 to December 1997, he served as Vice President and General Manager of Softworld Services, Inc. and from June 1992 to May 1995, as General Manager of Neodata Services, Inc. From January 1992 to May 1992, Mr. Lewis served as a consultant to Egghead Discount Software, Inc. From August 1986 to May 1992, Mr. Lewis served as Vice President of Distribution for Egghead Discount Software, Inc., from June 1981 to July 1986, as Divisional Vice President of Operations for Pay 'N Save Corporation and from April 1977 to May 1981, as Operations Manager of Distribution for Save On Drugs, Inc. Mr. Lewis holds a B.S. from the University of Dayton.

Paul W. Melmon has served as our Vice President of Engineering since April 1999. From August 1998 to April 1999, he served as an Entrepreneur in Residence at Sutter Hill Ventures, L.L.C., a private venture capital firm. From November 1996 to July 1998, Mr. Melmon served as Vice President of Engineering of Wallop Software, Inc. and from July 1994 to October 1996, as Director of Engineering of Scopus Technology, Inc. From October 1989 to July 1994, he held various technical positions at Sybase, Inc. and from November 1984 to October 1989, he served as a member of the technical staff at Hewlett- Packard Company. Mr. Melmon holds a B.S. from the University of California at Davis.

Kathryn C. Ringewald has served as our Vice President of Human Resources since April 1999. From June 1997 to April 1999, she served as Director of Human Resources of Form Factor, Inc. From August 1996 to May 1997, she served as Director of Human Resources of Berkeley Systems, Incorporated and from June 1995 to August 1996, as Vice President of Human Resources of Crystal Dynamics, Inc. From February 1994 to May 1995, Ms. Ringewald worked as a Director of Talent for Lucas Arts Entertainment Company and from October 1992 to February 1994, as a human resources consultant to various industries. From January 1990 to October 1992, she worked as a Human Resources Manager for Symantec Corporation and from June 1985 to January 1990, she served in various capacities at Apple Computer, Inc. Ms. Ringewald holds a B.A. from Dominican College.

John B. Balousek has served as one of our directors since October 1999. Mr. Balousek, a founder of PhotoAlley, Inc., served as its Executive Vice President from July 1998 to March 1999. He served as Chairman and Chief Executive Officer of True North Technologies, Inc. from March 1996 to June 1996. From March 1979 to March 1996, Mr. Balousek worked for Foote, Cone & Belding Communications, Inc. and served as its President and Chief Operating Officer from February 1991 to March 1996. He served as a director of Foote, Cone & Belding from May 1989 to May 1994, and then served as a director of True North Communications, Inc., a newly-created holding company of Foote, Cone & Belding, from June 1994 to February 1997. Mr. Balousek is also a director of Micron Electronics, Inc., Geoworks Corporation, FreeShop.com, Inc., Transilluminant Corporation, Worldwide Magnifi, Inc., and EDBH, Inc. He holds a B.A. from Creighton University and an M.S. from Northwestern University.

Matthew T. Cowan has served as one of our directors since June 1999. Mr. Cowan has been a general partner of Bowman Capital Management, L.L.C., a private venture capital firm, since October 1998. From July 1994 until September 1998, he served as a Director of Corporate Business Development for

Intel Corporation. Mr. Cowan is also a director of Support.com, Inc., ELetter Incorporated and sixdegrees, Inc. He holds a B.A. from Tufts University.

John R. Hummer has served as one of our directors since April 1999. Mr. Hummer is a general partner of Hummer Winblad Venture Partners, a private venture capital firm, which he co-founded in September 1989. From 1980 until 1989 he served as partner of Glenwood Management, a private venture capital firm. Mr. Hummer is also a director of Extensity, Inc., Industrywide Mortgage Exchange, Inc., The National Transportation Exchange, Inc., Mambo.com, and Netcontext, Inc. He holds a B.A. from Princeton University and an M.B.A. from Stanford University.

Randolph J. Tinsley has served as one of our directors since April 1999. Mr. Tinsley has served as Vice President of Corporate Development of Amazon.com, Inc. since April 1999 and as Director of Corporate Development from January 1998 to March 1999. He also served as Treasurer from January 1998 to November 1999. He served as Assistant Treasurer of Mergers and Acquisitions of Intel Corporation from August 1994 to January 1998 and as Senior Attorney from December 1992 to August 1994. From May 1989 to December 1992, he was an associate with Fenwick & West LLP and from June 1987 to May 1989, he was an associate with Orrick, Herrington & Sutcliffe LLP. Mr. Tinsley serves on the Board of Advisors of Spinnaker Crossover Fund, L.P. He holds a B.A. from the University of California at Berkeley and a J.D. from the University of Santa Clara.

## *Board Composition*

Our bylaws currently provide for a board of directors consisting of five directors. Each director is elected for a period of one year at our annual meeting of stockholders and serves until the next annual meeting or until his or her successor is duly elected and qualified. The executive officers serve at the discretion of the board of directors. There are no family relationships among any of our directors or executive officers. 45

## *Board Compensation*

Except for reimbursement for reasonable travel expenses relating to attendance at board and committee meetings and the grant of stock options, directors are not compensated for their services as directors. Our directors are eligible to participate in our 1999 Stock Plan and, upon the closing of this offering, directors who are employees of Pets.com will also be eligible to participate in our 2000 Employee Stock Purchase Plan. Julia Wainwright is the only director who is currently an employee. We have issued and sold to Ms. Wainwright 1,157,023 shares of common stock under our 1999 Stock Plan at a price of $0.01 per share. Ms. Wainwright's shares are subject to our right of repurchase at the original purchase price in the event that Ms. Wainwright's employment with Pets.com terminates. Our repurchase right lapses with respect to 25% of the shares purchased by Ms. Wainwright on March 10, 2000 and with respect to 1/48th of the shares on the 10th day of each month after that date. In addition, our repurchase right will lapse with respect to 50% of the remaining unvested shares held by Ms. Wainwright if she is terminated without cause within twelve months after a merger or sale of

Pets.com resulting in a change of control. We have also granted to Mr. Balousek an option to purchase up to 45,000 shares of common stock at an exercise price of $1.50 per share under our 1999 Stock Plan. Mr. Balousek's stock option vests at the rate of 25% of the shares subject to this option on October 29, 2000 and 1/48th of the shares subject to this option on the 29th day of each month after that date. For additional information, see "Stock Plans."

## *Board Committees*

In May 1999, our board of directors established an audit committee and a compensation committee. The audit committee reviews our annual audited financial results and unaudited quarterly results, and meets with our independent auditors to review our financial statements, internal controls and financial management practices. Our audit committee currently consists of John Balousek and Randolph Tinsley. Our compensation committee reviews and recommends to the board the compensation arrangements for our management team and administers our stock plans. Our compensation committee currently consists of John Hummer and Randolph Tinsley.

## *Compensation Committee Interlocks and Insider Participation*

The members of the compensation committee of our board of directors are currently John Hummer and Randolph Tinsley. Neither of them has at any time been an officer or employee of Pets.com or any subsidiary of Pets.com. However, we have issued and sold in private placement transactions shares of preferred stock to certain entities affiliated with Hummer Winblad Venture Partners and to Amazon.com. Mr. Hummer is a general partner of Hummer Winblad Venture Partners which manages certain investment funds that have purchased shares of our preferred stock, and Mr. Tinsley is Vice President, Corporate Development of Amazon.com that has purchased shares of our preferred stock and entered into an advertising agreement with us. The following is a summary of the stock purchase transactions between us and entities affiliated with Hummer Winblad Venture Partners, and between us and Amazon.com.

Entities Affiliated with Hummer Winblad Venture Partners - March 10, 1999: we issued a convertible promissory note in the principal amount of $142,500 to Hummer Winblad Venture Partners III, L.P. and a second convertible promissory note in the principal amount of $7,500 to Hummer Winblad Technology Fund III, L.P., which notes were canceled and converted into shares of Series A preferred stock at $1.45 per share on April 22, 1999.

- March 19, 1999: we issued a convertible promissory note in the principal amount of $237,500 to Hummer Winblad Venture Partners III, L.P. and a second convertible promissory note in the principal amount of $12,500 to Hummer Winblad Technology Fund III, L.P., which notes were canceled and converted into shares of Series A preferred stock at $1.45 per share on April 22, 1999.

- April 22, 1999: we issued and sold to Hummer Winblad Venture Partners III, L.P. 2,389,503 shares of Series A preferred stock and to Hummer Winblad Technology Fund III, L.P. 125,763 shares of Series A Preferred Stock, all at $1.45 per share, which included cancellation and 46 conversion of the promissory notes issued to each entity respectively on March 10, 1999 and March 19, 1999 (including conversion of accrued interest on the promissory notes).

- June 18, 1999: we issued and sold to Hummer Winblad Venture Partners III, L.P. and Hummer Winblad Technology Fund III, L.P. 899,669 shares and 47,351 shares, respectively, of our Series B preferred stock at $7.55 per share.

- November 5, 1999: we issued and sold to Hummer Winblad Venture Partners IV, L.P. 1,008,800 shares of Series B preferred stock at $7.55 per share and a convertible promissory note in the principal amount of $2,383,565, which note was cancelled and converted into shares of Series B Preferred Stock at $7.55 per share on December 8, 1999.

- December 8, 1999: we issued and sold to Hummer Winblad Venture Partners IV, L.P. 1,375,307 shares of Series B Preferred Stock at $7.55 per share, which included cancellation and conversion of the promissory note issued to this investor on November 5, 1999.

Amazon.com

- April 22, 1999: we issued and sold to Amazon.com 4,401,716 shares of Series A preferred stock at $1.45 per share.

- June 18, 1999: we issued and sold to Amazon.com 4,728,477 shares of Series B preferred stock at $7.55 per share.

- November 5, 1999: we issued and sold to Amazon.com 1,692,038 shares of Series B preferred stock at $7.55 per share and a convertible promissory note in the principal amount of $2,975,115, which note was canceled and converted into 394,055 shares of Series B preferred stock on December 8, 1999.

For additional information concerning compensation committee interlocks and insider participation in compensation decisions, please refer to our discussion of entities affiliated with Hummer Winblad Venture Partners and Amazon.com under "Related Party Transactions."

# *Executive Compensation*

The following table provides summary information concerning the compensation to be received for services rendered to us during the fiscal year ending December 31, 1999 by each person who served as our chief executive officer, or who acted in a similar capacity, and each of the other four most highly compensated executive officers, collectively, the "named officers," each of whose aggregate compensation during our last fiscal year exceeded $100,000.

# *Summary Compensation Table*

| NAME AND PRINCIPAL POSITION | ANNUAL COMPENSATION SALARY | BONUS | OTHER ANNUAL COMPENSATION | LONG-TERM COMPENSATION AWARDS SECURITIES UNDERLYING OPTIONS | ALL OTHER COMPENSATION |
|---|---|---|---|---|---|
| Julia L. Wainwright..... Chief Executive Officer | $147,568 | $ -- | $ -- | -- | $ -- |
| Christopher E. Deyo..... President | 134,009 | -- | -- | 653,969 | -- |
| Paul W. Melmon..... Vice President, Engineering | 111,009 | -- | -- | 278,950 | -- |
| John A. Hommeyer..... Vice President, Marketing | 103,395 | 20,000 | -- | 175,000 | 25,000 |
| Diane R. Hourany..... Vice President, Operations | 99,802 | 10,000 | -- | 157,204 | 320 |
| Gregory McLemore..... President | 39,231 | -- | -- | -- | -- |

Mr. McLemore served as President of Pets.com from February 1999 until April 1999. On an annualized basis, Mr. McLemore's salary would have been $150,000.

Paul Manca was hired as our Chief Financial Officer in August 1999. On an annualized basis, Mr. Manca's salary would have been $175,000.

Ralph Lewis was hired as our Vice President of Distribution and Logistics in November 1999. On an annualized basis, Mr. Lewis' salary would have been $200,000.

# *Option Grants*

The following table provides summary information regarding stock options granted to each of the named officers during the fiscal year ended December 31, 1999. The options were granted pursuant to our 1999 Stock Plan. All options are immediately exercisable; however, the underlying shares are subject to our right of repurchase at the original purchase price. Our repurchase right will lapse with respect to 25% of the shares on the one year anniversary of the vesting commencement date, and with respect to 1/48th of the shares each month thereafter. Stock price appreciation of 5% and 10% is assumed pursuant to rules promulgated by the Securities and Exchange Commission and does not represent our prediction of our stock performance. There is no assurance provided to any holder of our securities that the actual stock price appreciation over the ten-year option terms will be at the assumed 5% and 10% levels or at any other defined level.

# *Option Grants in Last Fiscal Year*

| | INDIVIDUAL GRANTS | | | | POTENTIAL REALIZABLE VALUE AT ASSUMED |
|---|---|---|---|---|---|
| | ---------- | ---------- | ---------- | ---------- | ---------- |

| NAME | NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED | PERCENT OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR | EXERCISE PRICE PER SHARE | EXPIRATION DATE | ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION TERM 5% | 10% |
|---|---|---|---|---|---|---|
| Julia L. Wainwright..... | -- | --% | $ -- | -- | $-- | $-- |
| Christopher E. Deyo..... | 653,969 | -- | 0.15 | 05/12/09 | -- | -- |
| Paul W. Melmon..... | 238,950 | -- | 0.15 | 05/12/09 | -- | -- |
| | 40,000 | -- | 0.75 | 07/29/09 | -- | -- |
| John A. Hommeyer..... | 150,000 | -- | 0.15 | 05/18/09 | -- | -- |
| | 25,000 | -- | 1.50 | 11/06/09 | -- | -- |
| Diane R. Hourany..... | 157,204 | -- | 0.15 | 05/12/09 | -- | -- |
| Gregory McLemore..... | -- | -- | -- | -- | -- | -- |

In August 1999, we granted the right to purchase 250,000 shares of our common stock to Paul Manca, our Chief Financial Officer at an exercise price of $0.75 per share, which shares are subject to our right of repurchase at the original purchase price in the event that Mr. Manca's employment with us terminates. Our repurchase right lapses with respect to 25% of the shares in August 2000 and with respect to 1/48th of the shares monthly thereafter. In November 1999, we granted an option exercisable for 175,000 shares of our common stock to Ralph Lewis, our Vice President of Distribution and Logistics. We granted options for an aggregate of 5,266,659 shares to our employees and consultants under our 1999 Stock Plan during our fiscal year ended December 31, 1999. See "Stock Plans." Options were granted at an exercise price equal to the fair market value of the common stock, as determined by our board of directors on the date of grant.

## *Aggregated Option Exercises in Last Fiscal Year and Fiscal Year Option Values*

The following table provides summary information concerning the shares of common stock acquired in the year ended December 31, 1999, the value realized upon exercise of stock options during that period, and the number and value of unexercised options with respect to each of the named officers as of December 31, 1999. The value was calculated by determining the difference between the fair market value of underlying common stock and the exercise price. All options are immediately exercisable; however, the underlying shares are subject to our right of repurchase at the original purchase price. Our repurchase right will lapse with respect to 25% of the shares on the one year anniversary of the vesting commencement date, and with respect to 1/48th of the shares each month thereafter.

# *Fiscal Year-end Option Values*

| NAME | SHARES ACQUIRED ON EXERCISE | VALUE REALIZED | NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT DECEMBER 31, 1999 EXERCISABLE | NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT DECEMBER 31, 1999 UNEXERCISABLE | VALUE OF IN-THE-MONEY OPTIONS AT DECEMBER 31, 1999 EXERCISABLE | VALUE OF IN-THE-MONEY OPTIONS AT DECEMBER 31, 1999 UNEXERCISABLE |
|---|---|---|---|---|---|---|
| Julia L. Wainwright..... | -- | $-- | -- | -- | $-- | $-- |
| Christopher E. Deyo..... | 653,969 | 0 | -- | -- | -- | -- |
| Paul W. Melmon..... | 238,950 | 0 | 40,000 | -- | | -- |
| John A. Hommeyer..... | 150,000 | 0 | 25,000 | -- | -- | -- |
| Diane R. Hourany..... | 157,204 | 0 | -- | -- | -- | -- |
| Gregory McLemore..... | -- | -- | -- | -- | -- | -- |

# *Stock Plans*

1999 Stock Plan. Our 1999 Stock Plan was adopted by our board of directors in February 1999 and approved by our stockholders in March 1999. The plan was amended at various times after February 1999 to increase the number of shares reserved for issuance thereunder. These amendments were approved by our stockholders. A total of 7,269,159 shares of common stock has been reserved for issuance under our stock plan. As of December 9, 1999, options to purchase 3,881,409 shares of common stock had been exercised, options to purchase a total of 1,335,250 shares at a weighted average exercise price of $1.48 per share were outstanding and 2,050,000 shares remained available for future grants under the plan.

In connection with this offering, our board amended the stock plan to provide for, among other things, an automatic annual increase in the number of shares of common stock reserved for issuance on the first day of each of our fiscal years beginning in 2001 and ending in 2009 equal to the lesser of:

- 1,000,000 shares;

- 3% of the shares outstanding on the last day of the immediately preceding fiscal year; or - a lesser number of shares as determined by our board of directors.

The purposes of our stock plan are to attract and retain the best available personnel, to provide additional incentives to our employees and consultants and to promote the success of our business. Our stock plan provides for the granting to employees, including officers and employee directors, of incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code") and for the granting to employees and consultants, including non-employee directors, of nonstatutory stock options and stock purchase rights. To the extent an optionee would

have the right in any calendar year to exercise for the first time one or more incentive stock options for shares having an aggregate fair market value (under all plans of Pets.com and determined for each share as of the date the option to purchase the shares was granted) in excess of $100,000, any such excess options will be treated as nonstatutory stock options. If not terminated earlier, our stock plan will terminate in February 2009.

Our stock plan may be administered by the board of directors or a committee of the board. Our stock plan is currently administered by our board of directors. The administrator determines the terms of options granted under our stock plan, including the number of shares subject to the option, exercise price, term and exercisability. In no event, however, may an individual employee receive option grants for more than 2,000,000 shares under the stock plan in any fiscal year. The exercise price of all incentive stock options granted under our stock plan must be at least equal to the fair market value of our common stock on the date of grant. The exercise price of any incentive stock option granted to an optionee who owns stock representing more than 10% of the total combined voting power of all classes of our outstanding capital stock must equal at least 110% of the fair market value of the common stock on the date of grant. The exercise price of all nonstatutory stock options and stock purchase rights shall be the price determined by the administrator, provided, however, that the exercise price of any nonstatutory stock option or stock purchase right granted to a named officer must equal at least 100% of the fair market value of the common stock on the date of grant in order for that grant to qualify as performance-based compensation under applicable tax law. Payment of the exercise price may be made in cash or other consideration as determined by the administrator.

The administrator determines the term of options, which may not exceed 10 years (5 years in the case of an incentive stock option granted to an optionee who owns stock representing more than 10% of the total combined voting power of all classes of our outstanding capital stock). Options and stock purchase rights are generally nontransferable. The administrator may grant nonstatutory stock options and stock purchase rights with limited transferability rights in circumstances specified in the stock plan. Each option and stock purchase right may generally be exercised during the lifetime of the optionee only by such optionee or a permitted transferee. The administrator determines the vesting terms of options and stock issued pursuant to stock purchase rights. Options granted under the 1999 Stock Plan generally may be exercised immediately after the grant date, but to the extent the shares subject to the options are not vested as of the date of exercise, we retain a right to repurchase any shares that remain unvested at the time of the optionee's termination of employment by paying an amount equal to the exercise price times the number of unvested shares. Options granted under the 1999 Stock Plan generally vest at the rate of 1/4th of the total number of shares subject to the options twelve months after the date of grant and 1/48th of the total number of shares subject to the options each month thereafter.

In addition to stock options, the administrator may issue stock purchase rights under the 1999 Stock Plan to employees, non-employee directors and consultants. The administrator determines the number of shares, price, terms, conditions and restrictions related to the grant of stock purchase rights. The purchase price of a stock purchase right granted under the 1999 Stock Plan will be determined by the administrator. The period during which the stock purchase right is held open is determined by the

administrator, but in no case shall this period exceed 30 days. Unless the administrator determines otherwise, the recipient of a stock purchase right must execute a restricted stock purchase agreement granting Pets.com an option to repurchase unvested shares at cost upon termination of recipient's relationship with us.

In the event of a change of control due to the sale of all or substantially all of our assets or merger of Pets.com with another corporation, then each option may be assumed or an equivalent option substituted by the successor corporation. If the successor corporation does not agree to an assumption or substitution, each outstanding stock option will terminate on the effective date of the transaction. Some option agreements issued by the administrator provide for limited acceleration of vesting in certain circumstances following a change of control transaction.

The administrator has the authority to amend or terminate our stock plan as long as this action would not adversely affect any outstanding option or stock purchase right and provided that stockholder approval is required for some amendments to the extent required by applicable law.

2000 Employee Stock Purchase Plan. Our 2000 Employee Stock Purchase Plan was adopted by the board of directors in December 1999 and approved by our stockholders in December 1999. A total of 500,000 shares of common stock have been reserved for issuance under our purchase plan, plus an automatic annual increase on the first day of each of our fiscal years beginning in 2001 and ending in 2010 equal to the lesser of:

- 300,000 shares;

- 1% of the shares outstanding on the last day of the immediately preceding fiscal year; or - a lesser number of shares as determined by our board.

Our purchase plan, which is intended to qualify under Section 423 of the Code, will be implemented by a series of overlapping offering periods of 24 months' duration, with new offering periods (other than the first offering period) commencing on February 1 and August 1 of each year. Each offering period will consist of four consecutive purchase periods of six months duration. The initial offering period is expected to commence on the date of this offering and end on January 31, 2002, and the initial purchase period is expected to end on July 31, 2000. The purchase plan will be administered by the board of directors or by a committee appointed by the board. Our employees (including officers and employee directors), and the employees of any majority-owned subsidiary designated by the board, are eligible to participate in the purchase plan if they are employed by us or any such subsidiary for at least 20 hours per week and more than five months per year. The purchase plan permits eligible employees to purchase common stock through payroll deductions, which may not exceed 20% of an employee's compensation, at a price equal to the lower of 85% of the fair market value of our common stock at the beginning of each offering period or at the end of each purchase period. In circumstances described in the purchase plan, the purchase price may be adjusted during an offering period to avoid our incurring adverse accounting charges. The maximum number of shares an employee may purchase during each purchase period is 2,000 shares, subject to certain IRS limitations specified in the plan. Employees may

end their participation in the offering at any time during the offering period, and participation ends automatically on termination of employment with us. If not terminated earlier, the purchase plan will have a term of ten years.

The purchase plan provides that in the event of our merger with or into another corporation or a sale of all or substantially all of our assets, each right to purchase stock under the purchase plan will be assumed or an equivalent right substituted by the successor corporation. If the successor corporation does not agree to assume or substitute stock purchase rights, our board of directors will shorten the offering periods then in effect so that employees' rights to purchase stock under the purchase plan are exercised prior to the merger or sale of assets. The board of directors has the power to amend or terminate the purchase plan as long as such action does not adversely affect any outstanding rights to purchase stock thereunder, provided however, that the board of directors may amend or terminate the purchase plan or an offering period even if it would adversely affect outstanding options in order to avoid our incurring adverse accounting charges.

## *Employee Benefit Plans*

401(k) Plan. We maintain a 401(k) tax-qualified employee savings and retirement plan covering all employees who satisfy eligibility requirements relating to minimum age and length of service. Pursuant to our 401(k) plan, eligible employees may elect to contribute up to 20% of their cash compensation to the 401(k) plan. The 401(k) plan is intended to qualify under applicable law, so that contributions to the 401(k) plan and income earned on the 401(k) plan contributions are not taxable until withdrawn. The 401(k) plan is available to our executive officers on terms not more favorable than those offered to other employees. We may elect to make contributions to the 401(k) plan at the discretion of our board of directors. No contributions have been made by us as of December 31, 1999. All employee contributions are 100% vested.

## *Employment and Change of Control Arrangements*

We have entered into the following employment and change of control arrangements with our current officers. For a description of arrangements with our former officers, directors and substantial stockholders, see "Related Party Transactions" on page 58.

In March 1999, we entered into a letter agreement with Julia Wainwright, our Chief Executive Officer. Under the agreement, Ms. Wainwright receives an annual salary of $185,000 and she was granted the right to purchase 1,157,023 shares of common stock at a purchase price of $0.01 per share, which shares are subject to our right of repurchase at the original purchase price in the event that Ms. Wainwright's employment with us terminates. Our repurchase right lapses with respect to 25% of the shares on March 10, 2000 and with respect to 1/48th of the shares monthly thereafter. In the event of a change of control, 50% of any remaining unvested shares held by Ms. Wainwright will accelerate and vest.

In March 1999, we entered into a letter agreement with Christopher Deyo, our President. Under the agreement, Mr. Deyo receives an annual salary of $185,000 and was granted an option to purchase 653,969 shares of common stock at an exercise price of $0.15 per share, 25% of which vest after one year of service, and 1/48th of the shares subject to the option vest every month thereafter. In the event of a change of control, 50% of any remaining unvested shares will accelerate and vest.

In August 1999, we entered into a letter agreement with Paul Manca, our Chief Financial Officer. Mr. Manca receives an annual salary of $175,000 and was granted the right to purchase 250,000 shares of common stock at an exercise price of $0.75 per share, which shares are subject to our right of repurchase at the original purchase price in the event that Mr. Manca's employment with us terminates. Our repurchase right lapses with respect to 25% of the shares in August 2000 and with respect to 1/48th of the shares monthly thereafter.

In April 1999, we entered into a letter agreement with John Benjamin, our Vice President of Merchandising. Under the agreement, Mr. Benjamin receives an annual salary of $125,000, relocation expenses of $25,000 and was granted an option to purchase 90,000 shares of common stock at an exercise price of $0.15 per share, 25% of which vest after one year of service and 1/48th of the shares subject to the option vest every month thereafter.

In March 1999, we entered into a letter agreement with John Hollon, our Vice President of Editorial. Under the agreement, Mr. Hollon receives an annual salary of $100,000, received a signing of bonus of $10,000 and was granted an option to purchase 125,000 shares of common stock at an exercise price of $0.15 per share, 25% of which vest after one year of service and 1/48th of the shares subject to the option vest every month thereafter.

In May 1999, we entered into a letter agreement with John Hommeyer, our Vice President of Marketing. Under the agreement, Mr. Hommeyer receives an annual salary of $165,000 and received a bonus of $20,000 and relocation expenses of $25,000. Mr. Hommeyer also was granted an option to purchase 150,000 shares of common stock at an exercise price of $0.15 per share, 25% of which vest after one year of service and 1/48th of the shares subject to the option vest every month thereafter. In the event Mr. Hommeyer is terminated with or without cause within one year after a change of control in connection with our merger or sale or if our office is moved more than fifty miles from our current San Francisco location, Mr. Hommeyer will receive severance equal to three months of his current monthly salary.

In April 1999, we entered into a letter agreement with Diane Hourany, our Vice President of Customer Service. Under the agreement, Ms. Hourany receives an annual salary of $150,000, received a bonus of $10,000 and an option to purchase 157,204 shares of common stock at an exercise price of $0.15 per share, 25% of which vest after one year of service and 1/48th of the shares subject to the option vest every month thereafter. In the event of a change in control, 25% of Ms. Hourany's remaining unvested shares will accelerate and become fully vested. In the event Ms. Hourany is terminated with or without cause within one year after a change of control in connection with our merger or sale or if our office is moved more than fifty miles from our current San Francisco location, Ms. Hourany will receive severance equal to three months of her current monthly salary.

In May 1999, we entered into a letter agreement with Sue Ann Latterman, our Vice President of Strategic Alliances. Under the agreement, Ms. Latterman receives an annual salary of $150,000, received a bonus of $10,000 and was granted an option to purchase 150,000 shares of common stock at an exercise price of $0.15 per share, 25% of which vest after one year of service and 1/48th of the shares subject to the option vest every month thereafter. In the event Ms. Latterman is terminated with or without cause within one year after a change of control in connection with our merger or sale or if our office is moved more than fifty miles from our current San Francisco location, Ms. Latterman will receive severance equal to three months of her current monthly salary.

In November 1999, we entered into a letter agreement with Ralph Lewis, our Vice President of Distribution and Logistics. Under the agreement, Mr. Lewis receives an annual salary of $200,000, received a bonus of $20,000, relocation expenses of $75,000, and was granted an option to purchase 175,000 shares of common stock at an exercise price of $1.50 per share, 25% of which vest after one year of service and 1/48th of the shares subject to the option vest every month thereafter. In the event Mr. Lewis is terminated with or without cause within one year after a change of control in connection with our merger or sale or if our office is moved more than fifty miles from our current San Francisco location, Mr. Lewis will receive severance equal to three months of his current salary.

In April 1999, we entered into a letter agreement with Paul Melmon, our Vice President of Engineering. Under the agreement, Mr. Melmon receives an annual salary of $160,000 and was granted an option to purchase 238,950 shares of common stock, 25% of which vest after one year of service and 1/48th of the shares subject to the option vest every month thereafter.

In March 1999, we entered into a letter agreement with Kathryn Ringewald, our Vice President of Human Resources. Under the agreement, Ms. Ringewald receives an annual salary of $120,000 and was granted an option to purchase 125,763 shares of common stock, 25% of which vest after one year of service and 1/48th of the shares subject to the option vest every month thereafter.

## *Limitation of Liability and Indemnification Matters*

As permitted by the Delaware General Corporation Law, we have included in our restated certificate of incorporation a provision to eliminate the personal liability of our officers and directors for monetary damages for breach or alleged breach of their fiduciary duties as officers or directors, respectively, subject to certain exceptions. In addition, our bylaws provide that we are required to indemnify our officers and directors under certain circumstances, including those circumstances in which indemnification would otherwise be discretionary, and we are required to advance expenses to our officers and directors as incurred in connection with proceedings against them for which they may be indemnified. We have entered into indemnification agreements with our officers and directors containing provisions that are in some respects broader than the specific indemnification provisions contained in Delaware Law. The indemnification agreements require that we, among other things, indemnify such officers and directors against certain liabilities that may arise by reason of their status or service as officers and directors (other than liabilities arising from willful misconduct of a culpable nature), to advance their expenses incurred as a result of any proceeding against them as to which they

could be indemnified, and to obtain directors' and officers' insurance if available on reasonable terms. We intend to obtain directors' and officers' liability insurance prior to the completion of this offering. At present, we are not aware of any pending or threatened litigation or proceeding involving any of our directors, officers, employees or agents in which indemnification would be required or permitted. We are not aware of any threatened litigation or proceeding that might result in a claim for such indemnification. We believe that our charter provisions and indemnification agreements are necessary to attract and retain qualified persons as directors and officers.

## *Related Party Transactions*

The following describes the significant transactions entered into between us and our directors, executive officers, stockholders and affiliates of our stockholders. All future transactions, other than compensation, stock options pursuant to our plans and other benefits to employees, generally will be approved by a majority of our board of directors including a majority of our independent and disinterested directors. If required by law, future transactions will be approved by a majority of our stockholders.

## *Stock Issuances to Our Directors, Officers and Principal Stockholders*

Some stock option grants to our directors and executive officers are described under the caption "Management -- Executive Compensation."

Since our inception, we have issued and sold shares of our common stock and granted options to purchase common stock to our employees, directors and consultants from time to time. In addition, we have issued in private placement transactions, shares of preferred stock as follows: an aggregate of 7,227,328 shares of Series A preferred stock at $1.45 per share in April 1999 and an aggregate of 13,148,347 shares of Series B preferred stock at $7.55 per share in June, November and December 1999. The following table summarizes the shares of common stock and preferred stock purchased by our named executive officers, directors and 5% stockholders and persons and entities associated with them:

| STOCKHOLDER | COMMON STOCK | SERIES A PREFERRED STOCK | SERIES B PREFERRED STOCK |
|---|---|---|---|
| Amazon.com, Inc. (Randolph J. Tinsley)..... | -- | 4,401,716 | 6,814,570 |
| Entities Affiliated with Bowman Capital Management, L.L.C. (Matthew T. Cowan)..... | -- | -- | 1,728,477 |
| Entities Affiliated with Hummer Winblad Venture Partners (John R. Hummer)..... | -- | 2,515,266 | 3,331,127 |
| Gregory McLemore..... | 1,610,587 | 275,863 | -- |

# *Debt Financings*

In March 1999 we issued and sold convertible promissory notes to our following named executive officers, directors and 5% stockholders and persons and entities associated with them, in the amounts set forth opposite each such party's name. The promissory notes were canceled and converted into share of our Series A preferred stock at $1.45 per share on April 22, 1999.

# *Amount of Stockholder Promissory Note(s)*

Entities Affiliated with Hummer Winblad Venture Partners (John R. Hummer)..... $450,000.00 In November 1999 we issued and sold convertible promissory notes to our following named executive officers, directors and 5% stockholders and persons and entities associated with them, in the amounts set forth opposite each such party's name. The promissory notes were cancelled and converted into shares of our Series B preferred stock at $7.55 per share on December 8, 1999.

# *Amount of Stockholder Promissory Note(s)*

| | |
|---|---|
| Amazon.com, Inc..... | $2,975,115.25 |
| Entities Affiliated with Bowman Capital Management, L.L.C..... | $1,430,136.10 |
| Entities Affiliated with Hummer Winblad Venture Partners.... | $2,383,565.20 |

# *Transactions with Directors and Officers*

Affiliate Relationships. The following members of our board of directors are affiliated with certain investors that participated in the transactions listed above: Randolph J. Tinsley (Amazon.com, Inc.), Matthew T. Cowan (entities affiliated with Bowman Capital Management, L.C.C.) and John Hummer (entities affiliated with Hummer Winblad Venture Partners).

In April 1999, we entered into an advertising agreement with Amazon.com pursuant to which we and Amazon.com agreed to display certain advertising of the other party on our respective Web sites and to provide other related promotional services. For more information on this relationship, see "Business -- Relationship with Amazon.com" and "Risk Factors -- We Depend on Our Relationship with Amazon.com to Provide Operational Expertise, Attract and Retain a Significant Number of Our Customers and Build Our Brand."

In connection with our Series A and Series B preferred stock financings, we entered into an agreement, as amended, dated November 5, 1999 with our preferred stockholders and a holder of over common stock in which we agreed, among other things and subject to applicable laws, rules and regulations, to use reasonable efforts to cause the underwriters in this offering to offer to Amazon.com that number of shares of our common stock such that Amazon.com would hold 46% of our outstanding common stock immediately after this offering. Under the agreement, the managing underwriters may prohibit Amazon.com from purchasing any shares in this offering or only allow Amazon.com to purchase a

number of shares which in their sole discretion will not jeopardize the success of this offering. We are currently negotiating a waiver from Amazon.com with respect to its right of first offer. The agreement further provides that if Amazon.com is unable in this offering to purchase enough shares to reach the 46% threshold, then to the extent the managing underwriters determine that the sale of additional shares will not jeopardize the success of this offering, we will use best efforts to offer and sell to Amazon.com, and Amazon.com may, but is not obligated to, purchase up to that number of additional shares in a private placement so that its ownership percentage is 46%. However, the agreement provides that the foregoing terms are not intended to be, and shall not be, construed as an offer by us to sell shares to Amazon.com. The agreement also provides that, if Amazon.com is unable in this offering and in the private placement offering described above to purchase enough shares to reach the 46% threshold, then for a period of one year following the closing of this offering, we will negotiate with Amazon.com to agree upon a means by which Amazon.com may purchase the number of shares that it was not permitted to purchase in this offering or the private placement described above to enable it to reach the 46% threshold. Furthermore, if Amazon.com is unable to achieve the 46% threshold in this offering, for one year following the closing of this offering, if we offer additional shares of our capital stock to any purchasers, Amazon.com shall have a right of first offer to purchase that number of the offered shares that will enable it to attain the 46% threshold. However, if Amazon.com disposes of any of our shares held by it, then all of its rights described above shall terminate. Pursuant to the agreement, Amazon.com also may not increase its ownership of our stock above the 46% threshold until the earliest to occur of the second anniversary of the closing date of our initial public offering, immediately following a change of control in connection with our merger or sale, or April 22, 2003. Until this occurs, we are required to provide notice to Amazon.com of any merger or sale that would result in our change of control. Additional terms of the agreement require that Amazon.com gives us notice of its purchase of any additional shares of our stock and complies with restrictions to allow us to qualify for pooling accounting treatment in the event of our merger or sale. In connection with proxy contests, tender offers or exchange offers, however, Amazon.com shall not be subject to the 46% threshold limit.

For information on employment and change in control arrangements with our officers, see "-- Employment and Change of Control Arrangements."

## *Other Transactions*

In February 1999, we issued 1,610,587 shares of our common stock to Greg McLemore in consideration of the transfer to us of the Pets.com Web store and certain domain names and software assets pursuant to a bill of sale and assignment by Mr. McLemore and Koala Computer Products, a sole proprietorship of which Mr. McLemore is sole proprietor.

In April 1999, we issued 275,863 shares of our Series A preferred stock to Mr. McLemore in consideration of the transfer to us by Mr. McLemore of certain domain names and agreements concerning domain names pursuant to a bill of sale and assignment.

We have reimbursed certain operating expenses of approximately $175,000 that were paid on our behalf by Koala Computer Products, of which Mr. McLemore is the sole proprietor, between February 1999 and the relocation of our executive offices to San Francisco in April 1999.

Mr. McLemore and Webmagic, a corporation of which Mr. McLemore is the sole shareholder, have agreed to indemnify us for up to $500,000 in connection with a third-party online promotional agreement entered into by Webmagic and the third party relating to the Pets.com business conducted by Mr. McLemore and Webmagic prior to April 1999.

In November 1999, we loaned $187,500 to Paul Manca, our Chief Financial Officer. Mr. Manca used the loan proceeds to exercise in November 1999 options held by him to purchase 250,000 shares of our common stock at an exercise price of $0.75 per share. These shares are subject to our right of repurchase at the original purchase price in the event that Mr. Manca's employment with us terminates. Our repurchase right lapses with respect to 25% of the shares in August 2000 and with respect to 1/48th of the shares monthly thereafter. The loan is full recourse, accrues interest at the rate of 6.08% compounded annually, and matures in November 2003 or on Mr. Manca's termination of employment. The loan is secured by the 250,000 shares of common stock held by Mr. Manca.

## *Indemnification Agreements*

We have entered into indemnification agreements with our officers and directors that contain provisions which may require us, among other things, to indemnify our officers and directors against liabilities that may arise by reason of their status or service as officers or directors (other than liabilities arising from willful misconduct of a culpable nature) and to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified. See "Management -- Limitation of Liability and Indemnification Matters."

## *Principal Stockholders*

The following table sets forth information regarding the beneficial ownership of our common stock as of December 9, 1999 and as adjusted to reflect the sale of the common stock offered by us under this prospectus and upon conversion of all outstanding shares of preferred stock into common stock by:

- each stockholder known to us to own beneficially more than 5% of our common stock;

- each of our directors and named officers; and - all directors and executive officers as a group.

Except as otherwise noted, the address of each person listed in the table is c/o Pets.com, Inc., 435 Brannan Street, Suite 100, San Francisco, California 94107. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and includes voting and investment power with respect to shares. To our knowledge, except under applicable community property laws or as otherwise indicated, the persons named in the table have sole voting and sole investment control with respect to all shares beneficially owned by each stockholder as of December 9,

1999. In computing the number of shares beneficially owned by a person and the percentage of ownership of that person, shares of common stock subject to options held by that person that are currently exercisable or exercisable within 60 days of December 9, 1999 are deemed outstanding. Those shares, however, are not deemed outstanding for the purposes of computing the percentage ownership of any other person. The percent of beneficial ownership for each stockholder is based on 26,068,921 shares of common stock outstanding as of December 9, 1999 on an as converted basis, and shares of common stock outstanding after this offering.

| NAME AND ADDRESS | SHARES BENEFICIALLY OWNED | PERCENT BENEFICIALLY OWNED | |
|---|---|---|---|
| | | BEFORE OFFERING | AFTER OFFERING |
| Amazon.com, Inc.<br>1200 12th Avenue South, Suite 1200<br>Seattle, WA 98108-1226 | 11,216,286 | 43.0% | % |
| Entities Affiliated with Hummer Winblad Venture Partners....<br>2 South Park, 2nd Floor<br>San Francisco, CA 94107 | 5,846,393 | 22.4% | % |
| Gregory McLemore | 1,886,450 | 7.2% | % |
| Entities Affiliated with Bowman Capital Management, L.L.C.<br>1875 South Grant Street, Suite 600<br>San Mateo, CA 94402-7013 | 1,728,477 | 6.6% | % |
| Randolph J. Tinsley | 11,216,286 | 43.0% | % |
| John R. Hummer | 5,846,393 | 22.4% | % |
| Matthew T. Cowan | 1,728,477 | 6.6% | % |
| John B. Balousek | 45,000 | * | * |
| Julia L. Wainwright | 1,157,023 | 4.4% | % |
| Christopher E. Deyo | 653,969 | 2.5% | % |
| Paul W. Melmon | 278,950 | 1.1% | % |
| John A. Hommeyer | 150,000 | * | * |
| Diane R. Hourany | 157,204 | * | * |
| All executive officers and directors as a group (15 persons) | 22,149,065 | 83.8% | % |

* Less than 1% of the outstanding shares of common stock.

The beneficial ownership for entities affiliated with Hummer Winblad Venture Partners is comprised of 3,289,172 shares held by Hummer Winblad Venture Partners III, L.P., 173,114 shares held by Hummer Winblad Technology Fund III, L.P., and 2,384,107 shares held by Hummer Winblad Venture Partners IV, L.P. The general partner of each of the first two funds listed in the first sentence of this paragraph is Hummer Winblad Equity Partners III, LLC, and the general partner of the third fund is Hummer Winblad Equity Partners IV, LLC. The members of each of the foregoing general partners are principals of Hummer Winblad Venture Partners.

The beneficial ownership for entities affiliated with Bowman Capital Management, L.L.C. is comprised of 607,933 shares held by Spinnaker Technology Fund, L.P., 371,764 shares held by Spinnaker Founders Fund, L.P., 24,901 shares held by Spinnaker Clipper Fund, L.P., 512,697 shares held by Spinnaker Technology Offshore Fund Limited, and 211,182 shares held by Spinnaker Offshore

Founders Fund Cayman Limited. Bowman Capital Management, L.C.C. is the general partner of each of the first three entities and investment adviser to the last two offshore entities listed in the first sentence of this paragraph.

The beneficial ownership for Randolph J. Tinsley is comprised of 11,216,286 shares held by Amazon.com. Mr. Tinsley is a director of Pets.com and Vice President of Corporate Development of Amazon.com and he disclaims beneficial ownership of these shares except to the extent of his pecuniary interest in these shares.

The beneficial ownership for John R. Hummer is comprised of 3,289,172 shares held by Hummer Winblad Venture Partners III, L.P., 173,114 shares held by Hummer Winblad Technology Fund III, L.P., and 2,384,107 shares held by Hummer Winblad Venture Partners IV, L.P. Mr. Hummer is a director of Pets.com and a member of each of Hummer Winblad Equity Partners III, LLC and Hummer Winblad Equity Partners IV, LLC, the general partners for the three investment funds listed in the first two sentences of this paragraph, and he disclaims beneficial ownership of these shares except to the extent of his pecuniary interest in these shares.

The beneficial ownership for Matthew T. Cowan is comprised of 607,933 shares held by Spinnaker Technology Fund, L.P., 371,764 shares held by Spinnaker Founders Fund, L.P., 24,901 shares held by Spinnaker Clipper Fund, L.P., 512,697 shares held by Spinnaker Technology Offshore Fund Limited, and 211,182 shares held by Spinnaker Offshore Founders Fund Cayman Limited. Mr. Cowan is a director of Pets.com and a member of Bowman Capital Management, L.C.C., the general partner of each of the first three entities listed in the first sentence of this paragraph and investment adviser to the last two entities listed in the first sentence of this paragraph, and he disclaims beneficial ownership of these shares except to the extent of his pecuniary interest in these shares.

The beneficial ownership for John B. Balousek includes 45,000 shares under outstanding stock options that are currently exercisable or exercisable within 60 days of December 9, 1999.

The beneficial ownership for Paul W. Melmon includes 40,000 shares under outstanding stock options that are currently exercisable or exercisable within 60 days of December 9, 1999.

The beneficial ownership for our executive officers and directors as a group includes 350,000 shares under outstanding stock options that are currently exercisable or exercisable within 60 days of December 9, 1999.

# *Description of Capital Stock*

Upon the completion of this offering, our authorized capital stock will consist of 150,000,000 shares of common stock, $0.001 par value per share, and 5,000,000 shares of undesignated preferred stock, $0.001 par value per share.

## *Common Stock*

As of December 9, 1999, there were 26,068,921 shares of common stock outstanding held of record by 120 stockholders. Options to purchase an aggregate of 1,335,250 shares of common stock were also outstanding. There will be shares of common stock outstanding, assuming no exercise of the underwriter's option to purchase additional shares, or exercise of outstanding options under our stock plans after December 9, 1999, after giving effect to the sale of the shares of common stock offered to the public in this prospectus.

The holders of common stock are entitled to one vote for each share held of record on all matters submitted to a vote of the stockholders. Subject to preferences that may be applicable to any outstanding preferred stock, holders of common stock are entitled to receive ratably such dividends as may be declared by the board of directors out of funds legally available for that purpose. In the event of liquidation, dissolution or winding up of Pets.com, the holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to the prior distribution rights of any outstanding preferred stock. The common stock has no preemptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions applicable to the common stock. The outstanding shares of common stock are, and the shares of common stock to be issued upon completion of this offering will be, fully paid and non-assessable.

## *Preferred Stock*

Upon the closing of the offering, the board of directors will have the authority, without further action by the stockholders, to issue up to 5,000,000 shares of preferred stock. The board of directors will also have the authority to designate the rights, preferences, privileges and restrictions of each such series, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences and the number of shares constituting any series.

The issuance of preferred stock may have the effect of delaying, deferring or preventing a change of control of Pets.com without further action by the stockholders. The issuance of preferred stock with voting and conversion rights may also adversely affect the voting power of the holders of common stock. In some circumstances, an issuance of preferred stock could have the effect of decreasing the market price of the common stock. As of the closing of the offering, no shares of preferred stock will be outstanding and we currently have no plans to issue any shares of preferred stock.

## *Registration Rights*

As of December 9, 1999, the holders of 21,986,262 shares of common stock or their transferees are entitled to certain rights with respect to the registration of such shares under the Securities Act. These rights are provided under the terms of an agreement between the holders of these registrable securities and us. Subject to limitations in the agreement, the holders of at least 33 1/3% of the then outstanding registrable securities may require, on two occasions beginning six months after the date of this

prospectus, that we use our best efforts to register these securities for public resale if Form S-3 is not available. If we register any of our common stock either for our own account or for the account of other security holders, all holders of these securities are entitled to include their shares of common stock in that registration, subject to the ability of the underwriters to limit the number of shares included in the offering. The holders of at least 30% of the then outstanding registrable securities may also require that we, not more than twice in any twelve-month period, register all or a portion of such securities on Form S-3 when the use of that form becomes available to us, provided, among other limitations, that the proposed aggregate selling price, net of any underwriters' discounts or commissions, is at least $1,000,000. We will be 60 responsible for paying all registration expenses, and the holders selling their shares will be responsible for paying all selling expenses.

## *Anti-takeover Provisions of Delaware Law and Our Charter Documents*

Provisions of Delaware law and our charter documents could make the acquisition of Pets.com and the removal of incumbent officers and directors more difficult. These provisions are expected to discourage certain types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of Pets.com to negotiate with us first. We believe that the benefits of increased protection of our potential ability to negotiate with the proponent of an unfriendly or unsolicited proposal to acquire or restructure Pets.com outweigh the disadvantages of discouraging such proposals because, among other things, negotiation of such proposals could result in an improvement of their terms.

Delaware Law. We are subject to the provisions of Section 203 of the Delaware law. In general, the statute prohibits a publicly-held Delaware corporation from engaging in a "business combination" with an "interested stockholder" for a period of three years after the date that the person became an interested stockholder unless, subject to exceptions, the business combination or the transaction in which the person became an interested stockholder is approved in a prescribed manner. Generally, a "business combination" includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the stockholder. Generally, an "interested stockholder" is a person who, together with affiliates and associates, owns, or within three years prior, did own, 15% or more of the corporation's voting stock. These provisions may have the effect of delaying, deferring or preventing a change of control of Pets.com without further action by the stockholders.

Charter Documents. Our amended and restated certificate of incorporation provides that stockholder action can be taken only at an annual or special meeting of stockholders and may not be taken by written consent. Our bylaws provide that special meetings of stockholders can be called only by the board of directors, the chairman of the board, if any, the president and holders of 50% of the votes entitled to be cast at a meeting. Moreover, the business permitted to be conducted at any special meeting of stockholders is limited to the business brought before the meeting by the board of directors, the chairman of the board, if any, the president or any such 50% holder. Our bylaws set forth an

advance notice procedure with regard to the nomination, other than by or at the direction of the board of directors, of candidates for election as directors and with regard to business to be brought before a meeting of stockholders.

## *Transfer Agent and Registrar*

The transfer agent and registrar for our common stock is U.S. Stock Transfer Corporation. The transfer agent's address and telephone number is 1745 Gardena Avenue, 2nd Floor, Glendale, California 91204, (818) 502-1404.

## *Nasdaq Stock Market Listing*

We intend to apply for listing for quotation on the Nasdaq National Market under the trading symbol "IPET."

## *Shares Eligible for Future Sale*

Prior to this offering, there has been no market for our common stock. Future sales of substantial amounts of our common stock in the public market could adversely affect prevailing market prices. Furthermore, only a limited number of shares will be available for sale shortly after this offering because of certain contractual and legal restrictions on resale. Sales of substantial amounts of our common stock in the public market after the restrictions lapse could adversely affect the prevailing market price and our ability to raise equity capital in the future.

Upon completion of the offering, we will have outstanding shares of common stock, based on the number of shares outstanding as of December 9, 1999. Of these shares, the shares sold in the offering, plus any shares issued upon exercise of the underwriters' option to purchase additional shares, will be freely tradable without restriction under the Securities Act, unless purchased by our "affiliates," as that term is defined in Rule 144 under the Securities Act. In general, affiliates include officers, directors or 10% stockholders.

The remaining 26,068,921 shares of our common stock outstanding are "restricted securities" within the meaning of Rule 144. These shares may be sold in the public market only if registered or if they qualify for an exemption from registration under Rules 144, 144(k) or 701 of the Securities Act, which are summarized below. Sales of these shares in the public market, or the availability of such shares for sale, could adversely affect the market price of our common stock.

Our directors, officers, employees and other stockholders have entered into lock-up agreements in connection with this offering generally providing that they will not, without the prior written consent of Merrill Lynch, Pierce, Fenner & Smith Incorporated, directly or indirectly, offer, pledge, sell, contract to sell or sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant for the sale of, or otherwise dispose of their shares of our common stock or any

securities exercisable for or convertible into shares of our common stock for a period of 180 days following the effective date of the registration statement filed pursuant to this offering. As a result of these contractual restrictions, notwithstanding possible earlier eligibility for sale under the provisions of Rules 144, 144(k) and 701, shares subject to lock-up agreements will not be saleable until such agreements expire or are waived by Merrill Lynch, Pierce, Fenner & Smith Incorporated.

Taking into account the lock-up agreements, and assuming Merrill Lynch, Pierce, Fenner & Smith Incorporated does not release stockholders from these agreements, the following shares will be eligible for sale in the public market at the following times:

## *Number of Date of Availability for Sale Shares*

30 days after the date of the final prospectus..... 180 days after the date of the final prospectus..... At various times between the date 180 days after the date of the final prospectus and November 5, 2000..... At various times between November 5, 2000 and December 8, 2000..... At various times thereafter upon the expiration of applicable holding periods.....

Under Rule 144, the number of shares that may be sold by affiliates of our stockholders are subject to volume restrictions. In general, under Rule 144, and beginning after the expiration of the lock-up agreements, a person who has beneficially owned restricted shares, including shares that are aggregated to such person or persons, for at least one year would be entitled to sell within any three-month period a number of shares that does not exceed the greater of:

- one percent of the number of shares of common stock then outstanding which will equal approximately shares immediately after the offering; or - the average weekly trading volume of the common stock during the four calendar weeks preceding the filing of a Form 144 with respect to the sale.

In order to sell shares under Rule 144, the selling stockholder must comply with manner of sale provisions and notice requirements and current public information about us must be available. Under Rule 144(k), a person who is not deemed to have been our affiliate at any time during the three months preceding a sale, and who has beneficially owned the shares proposed to be sold for at least two years, is entitled to sell such shares without complying with the manner of sale, public information, volume limitation or notice provisions of Rule 144.

The holders of approximately 20,375,675 shares of common stock or their transferees are also entitled to certain rights with respect to registration of their shares of common stock for offer or sale to the public. If the holders, by exercising their registration rights, cause a large number of shares to be registered and sold in the public market, the sales could have a material adverse effect on the market price of our common stock.

As part of the lock-up agreements, all of our employees holding common stock or stock options may not sell shares acquired upon exercise of their options until 180 days after the effective date. Beginning 180 days after the effective date, any of our employees, officers, directors of or consultants who purchased his or her shares pursuant to a written compensatory plan or contract may be entitled to rely on the resale provisions of Rule 701. Rule 701 permits affiliates to sell their Rule 701 shares under Rule 144 without complying with the holding period requirements of Rule 144. Rule 701 further provides that non-affiliates may sell their shares in reliance on Rule 144 without having to comply with the holding period, public information, volume limitation or notice provisions of Rule 144. In addition, we intend to file one or more registration statements under the Securities Act as promptly as possible after the effective date to register shares to be issued under our employee benefit plans. As a result, any options exercised under our stock option plans or any other benefit plan after the effectiveness of a registration statement will also be freely tradable in the public market, unless the shares are held by affiliates of ours. Shares held by our affiliates will still be subject to the volume limitation, manner of sale, notice and public information requirements of Rule 144 unless the shares may otherwise be sold under Rule 701. As of December 9, 1999 there were outstanding options for the purchase of 1,335,250 shares, of which 740,000 shares subject to those options were exercisable. No shares have been issued to date under our purchase plan or directors plan. See "Risk Factors -- Shares Eligible for Future Sale," "Management -- Stock Plans" and "Description of Capital Stock -- Registration Rights."

# *Underwriting*

## *General*

We are offering our shares in the U.S. and Canada through the U.S. underwriters and elsewhere through the international managers. Merrill Lynch, Pierce, Fenner & Smith Incorporated, Bear, Stearns & Co. Inc. Thomas Weisel Partners LLC, and Warburg Dillon Read LLC are acting as U.S. representatives of the U.S. underwriters named below. Subject to the terms and conditions described in a U.S. purchase agreement among us and the U.S. underwriters, and concurrently with the sale of shares to the international managers, we have agreed to sell to the U.S. underwriters, and the U.S. underwriters severally have agreed to purchase from us the number of shares listed opposite their names below.

## *Underwriters Number of Shares*

Merrill Lynch, Pierce, Fenner & Smith Incorporated..... Bear, Stearns & Co. Inc.....
Thomas Weisel Partners LLC..... Warburg Dillon Read LLC.....

Total.....

We have also entered into an international purchase agreement with the international managers for sale of the shares outside the U.S. and Canada for whom Merrill Lynch International is acting as lead manager. Subject to the terms and conditions in the international purchase agreement, and concurrently with the sale of shares to the U.S. underwriters pursuant to the U.S. purchase agreement, we have agreed to sell to the international managers, and the international managers severally have agreed to purchase shares from us. The initial public offering price per share and the total underwriting discount per share are identical under the U.S. purchase agreement and the international purchase agreement.

The U.S. underwriters and the international managers have agreed to purchase all of the shares sold under the U.S. and international purchase agreements if any of these shares are purchased. If an underwriter defaults, the U.S. and international purchase agreements provide that the purchase commitments of the nondefaulting underwriters may be increased or the purchase agreements may be terminated. The closings for the sale of shares to be purchased by the U.S. underwriters and the international managers are conditioned on one another.

We have agreed to indemnify the U.S. underwriters and the international managers against certain liabilities, including liabilities under the Securities Act, or to contribute to payments the U.S. underwriters and international managers may be required to make in respect of those liabilities.

The underwriters are offering the shares, subject to prior sale, when, as and if issued to and accepted by them, subject to approval of legal matters by their counsel, including the validity of the shares, and other conditions contained in the purchase agreements, such as the receipt by the underwriters of officer's certificates and legal opinions. The underwriters reserve the right to withdraw, cancel or modify offers to the public and to reject orders in whole or in part.

## *Commissions and Discounts*

The U.S. representatives have advised us that the U.S. underwriters propose initially to offer the shares to the public at the initial public offering price set forth on the cover page of this prospectus and to dealers at that price less a concession not in excess of $ per share. The U.S. underwriters may allow, and the dealers may reallow, a discount not in excess of $ per share to other dealers. After the initial public offering, the public offering price, concession and discount may be changed.

The following table shows the per share and total public offering price, underwriting discount and proceeds before expenses to Pets.com. The information assumes either no exercise or full exercise by the U.S. underwriters and the international managers of their over-allotment options.

## *Per Share Without Option with Option*

| | | | |
|---|---|---|---|
| Public offering price | $ | $ | $ |
| Underwriting discount | $ | $ | $ |
| Proceeds, before expenses, to Pets.com | $ | $ | $ |

The total expenses of the offering, not including the underwriting discount, are estimated at $1,000,000 and are payable by Pets.com.

## *Intersyndicate Agreement*

The U.S. underwriters and the international managers have entered into an intersyndicate agreement that provides for the coordination of their activities. Under the intersyndicate agreement, the U.S. underwriters and the international managers may sell shares to each other for purposes of resale at the initial public offering price, less an amount not greater than the selling concession. Under the intersyndicate agreement, the U.S. underwriters and any dealer to whom they sell shares will not offer to sell or sell shares to persons who are non-U.S. or non-Canadian persons or to persons they believe intend to resell to persons who are non-U.S. or non-Canadian persons, except in the case of transactions under the intersyndicate agreement. Similarly, the international managers and any dealer to whom they sell shares will not offer to sell or sell shares to U.S. persons or Canadian persons or to persons they believe intend to resell to U.S. or Canadian persons, except in the case of transactions under the intersyndicate agreement.

## *Over-allotment Option*

We have granted an option to the U.S. underwriters to purchase up to additional shares at the public offering price less the underwriting discount. The U.S. underwriters may exercise this option for 30 days from the date of this prospectus solely to cover any over-allotments. If the U.S. underwriters exercise this option, each will be obligated, subject to conditions contained in the purchase agreements, to purchase a number of additional shares proportionate to that U.S. underwriter's initial amount reflected in the above table.

We have also granted an option to the international managers, exercisable for 30 days from the date of this prospectus, to purchase up to additional shares to cover any over-allotments on terms similar to those granted to the U.S. underwriters.

## *Reserved Shares*

At our request, the underwriters have reserved for sale, at the initial public offering price, up to 5% of the shares offered by this prospectus for sale to some of our directors, officers, employees, business associates and related persons. If these persons purchase reserved shares, the number of shares available for sale to the general public will be reduced accordingly. Any reserved shares that are not orally confirmed for purchase within one business day of the pricing of this offering will be offered by the underwriters to the general public on the same terms as the other shares offered by this prospectus.

## *No Sales of Similar Securities*

We and our executive officers and directors and all existing stockholders have agreed, with exceptions, not to sell or transfer any common stock for 180 days after the date of this prospectus without first obtaining the written consent of Merrill Lynch, Pierce, Fenner & Smith Incorporated. Specifically, we and these other individuals have agreed not to directly or indirectly - offer, pledge, sell or contract to sell any common stock, - sell any option or contract to purchase any common stock, - purchase any option or contract to sell any common stock, - grant any option, right or warrant for the sale of any common stock, - lend or otherwise dispose of or transfer any common stock, - request or demand that we file a registration statement related to the common stock, or - enter into any swap or other agreement that transfers, in whole or in part, the economic consequence of ownership of any common stock whether any such swap or transaction is to be settled by delivery of shares or other securities, in cash or otherwise.

This lockup provision applies to common stock and to securities convertible into or exchangeable or exercisable for or repayable with common stock. It also applies to common stock owned now or acquired later by the person executing the agreement or for which the person executing the agreement later acquires the power of disposition.

## *Quotation on the Nasdaq National Market*

We expect the shares to be approved for quotation on the Nasdaq National Market, subject to notice of issuance, under the symbol "IPET."

Before this offering, there has been no public market for our common stock. The initial public offering price will be determined through negotiations among us and the U.S. representatives and lead managers. In addition to prevailing market conditions, the factors to be considered in determining the initial public offering price are - the valuation multiples of publicly traded companies that the U.S. representatives and the lead managers believe to be comparable to us, - our financial information, - the history of, and the prospects for, our company and the industry in which we compete, - an assessment of our management, its past and present operations, and the prospects for, and timing of, our future revenues, - the present state of our development, and - the above factors in relation to market values and various valuation measures of other companies engaged in activities similar to ours.

An active trading market for the shares may not develop. It is also possible that after the offering the shares will not trade in the public market at or above the initial public offering price.

The underwriters do not expect to sell more than 5% of the shares being offered in this offering to accounts over which they exercise discretionary authority.

Thomas Weisel Partners LLC, one of the representatives of the underwriters, was organized and registered as a broker-dealer in December 1998. Since December 1998, Thomas Weisel Partners LLC has been named as a lead or co-manager on 91 filed public offerings of equity securities, of which 78 have been completed, and has acted as a syndicate member in an additional 48 public offerings of

equity securities. Thomas Weisel Partners LLC does not have any material relationship with us or any of our officers, directors or controlling persons, except with respect to its contractual relationship with us under the underwriting agreement entered into in connection with this offering.

## *Price Stabilization, Short Positions and Penalty Bids*

Until the distribution of the shares is completed, SEC rules may limit underwriters from bidding for and purchasing our common stock. However, the U.S. representatives may engage in transactions that stabilize the price of the common stock, such as bids or purchases to peg, fix or maintain that price.

If the underwriters create a short position in the common stock in connection with the offering, i.e., if they sell more shares than are listed on the cover of this prospectus, the U.S. representatives may reduce that short position by purchasing shares in the open market. The U.S. representatives may also elect to reduce any short position by exercising all or part of the over-allotment option described above. Purchases of the common stock to stabilize its price or to reduce a short position may cause the price of the common stock to be higher than it might be in the absence of such purchases.

The U.S. representatives may also impose a penalty bid on underwriters and selling group members. This means that if the U.S. representatives purchase shares in the open market to reduce the underwriter's short position or to stabilize the price of such shares, they may reclaim the amount of the selling concession from the underwriters and selling group members who sold those shares. The imposition of a penalty bid may also affect the price of the shares in that it discourages resales of those shares.

Neither we nor any of the underwriters makes any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the common stock. In addition, neither we nor any of the underwriters makes any representation that U.S. representatives or the lead managers will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

## *Legal Matters*

The validity of the common stock offered hereby will be passed upon for Pets.com by Venture Law Group, A Professional Corporation, Menlo Park, California. John V. Bautista, a director at Venture Law Group, is a Secretary of Pets.com. Legal matters specified by the underwriters in connection with this offering will be passed upon for the underwriters by Shearman & Sterling, Menlo Park, California. As of the date of this prospectus, an investment partnership associated with Venture Law Group owns an aggregate of 56,877 shares of our common stock, and certain directors and attorneys of Venture Law Group beneficially own a total of 60,719 shares of our common stock.

## *Experts*

Ernst & Young LLP, independent auditors, have audited our financial statements as of September 30, 1999 and for the period from February 17, 1999 (inception) to September 30, 1999, as set forth in their report. The financial statements audited by Ernst & Young LLP have been included in reliance on their report given on their authority as experts in accounting and auditing.

## *Additional Information*

We have filed with the Securities and Exchange Commission, a registration statement on Form S-1, including the exhibits and schedules filed with the registration statement, under the Securities Act with respect to the shares of common stock offered hereby. This prospectus does not contain all the information set forth in the registration statement and the exhibits and schedules thereto. For further information with respect to us and our common stock, we refer you to the registration statement. Statements contained in this prospectus as to the contents of any contract or other document referred to are not necessarily complete, and in each instance reference is made to the copy of such contract or other document filed as an exhibit to the registration statement, each such statement being qualified in all respects by such reference. A copy of the registration statement may be inspected by anyone without charge at the Public Reference Section of the SEC at Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of all or any portion of the registration statement may be obtained from the Public Reference Section of the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549, upon payment of prescribed fees. The SEC maintains a Web site at http://www.sec.gov that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC.

# *Pets.com, Inc.*

# *Financial Statements*

# *Period from February 17, 1999 (Inception) to September 30, 1999*

# *Contents*

# *Page*

Report of Independent Auditors..... F-2 Audited Financial Statements Balance Sheet..... F-3 Statement of Operations..... F-4 Statement of Stockholders' Equity..... F-5 Statement of Cash Flows..... F-6 Notes to Financial Statements..... F-7

# *Report of Independent Auditors*

The Board of Directors and Stockholders Pets.com, Inc.

We have audited the accompanying balance sheet of Pets.com, Inc. as of September 30, 1999, and the related statements of operations, stockholders' equity, and cash flows for the period from February 17, 1999 (inception) to September 30, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pets.com, Inc. at September 30, 1999, and the results of its operations and its cash flows for the period from February 17, 1999 (inception) to September 30, 1999, in conformity with generally accepted accounting principles.

/s/ Ernst & Young LLP San Francisco, California December 6, 1999, except for Paragraph 3 of Note 8 as to which the date is December 8, 1999

# *Pets.com, Inc.*

BALANCE SHEET (IN THOUSANDS, EXCEPT SHARE DATA) SEPTEMBER 30, 1999

| | |
|---|---|
| ASSETS | |
| Current assets: | |
| Cash and cash equivalents | $ 36,231 |
| Inventories | 1,872 |
| Prepaid advertising expenses | 2,214 |
| Other prepaid expenses and current assets | 411 |
| Total current assets | 40,728 |
| Certificate of deposit | 150 |
| Fixed assets, net | 7,249 |
| Other assets | 272 |
| Total assets | $ 48,399 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | |
| Current liabilities: | |
| Accounts payable | $ 5,495 |
| Accrued expenses | 193 |
| Other | 127 |
| Total current liabilities | 5,815 |
| Stockholders' equity: | |
| Convertible preferred stock, $.001 par value: | |
| Authorized shares -- 14,127,328 | |
| Series A preferred stock, designated 7,227,328 shares Issued and outstanding shares -- 7,227,328 (aggregate liquidation preference of $10,480) | 7 |
| Series B preferred stock, designated 6,900,000 shares Issued and outstanding shares -- 6,622,517 (aggregate liquidation preference of $50,000) | 7 |
| Common stock, $.001 par value: | |
| Authorized shares -- 30,000,000 | |
| Issued and outstanding shares -- 5,098,746 | 5 |
| Additional paid-in capital | 73,671 |
| Accumulated deficit | (19,355) |
| Stock-based compensation | (11,751) |
| Total stockholders' equity | 42,584 |
| Total liabilities and stockholders' equity | $ 48,399 |

See accompanying notes.

# *Pets.com, Inc.*

STATEMENT OF OPERATIONS (IN THOUSANDS, EXCEPT SHARE DATA) PERIOD FROM FEBRUARY 17, 1999 (INCEPTION) TO SEPTEMBER 30, 1999

| | |
|---|---|
| Net sales | $ 619 |
| Cost of goods sold | (1,842) |
| Gross margin | (1,223) |
| Operating expenses: | |
| Marketing and sales | 11,815 |
| Product development | 3,835 |
| General and administrative | 2,043 |
| Amortization of stock-based compensation | 1,139 |

| | |
|---|---|
| Total operating expenses | (18,832) |
| Operating loss | (20,055) |
| Interest income, net | 700 |
| Net loss | $ (19,355) |
| Basic and diluted net loss per share | $ (10.84) |
| Weighted average shares outstanding used to compute basic and diluted net loss per share | 1,786,156 |

See accompanying notes.

# *Pets.com, Inc.*

## STATEMENT OF STOCKHOLDERS' EQUITY (IN THOUSANDS, EXCEPT SHARE DATA) PERIOD FROM FEBRUARY 17, 1999 (INCEPTION) TO SEPTEMBER 30, 1999

| | CONVERTIBLE PREFERRED STOCK SERIES A | | SERIES B | | COMMON STOCK | | ADDITIONAL PAID-IN CAPITAL | ACCUMULATED DEFICIT | STOCK-BASED COMPENSATION | TOTAL STOCKHOLDERS' EQUITY |
|---|---|---|---|---|---|---|---|---|---|---|
| | SHARES | AMOUNT | SHARES | AMOUNT | SHARES | AMOUNT | | | | |
| Initial issuance of common shares to founders in exchange for cash and intellectual property | -- | $-- | -- | $-- | 1,811,837 | $2 | $ 16 | $ -- | $ -- | $ 18 |
| Issuance of restricted shares to employee | -- | -- | -- | -- | 1,157,023 | 1 | 11 | -- | -- | 12 |
| Issuance of Series A preferred stock in April, net of offering costs of $59 | 7,227,328 | 7 | -- | -- | -- | -- | 10,414 | -- | -- | 10,421 |
| Issuance of Series B preferred stock in June, net of offering costs of $39 | -- | -- | 6,622,517 | 7 | -- | -- | 49,954 | -- | -- | 49,961 |
| Exercise of common stock options | -- | -- | -- | -- | 2,129,886 | 2 | 386 | -- | -- | 388 |
| Compensation related to issuance of stock options and restricted common stock | -- | -- | -- | -- | -- | -- | 12,890 | -- | -- | 12,890 |
| Amortization of stock-based compensation | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Net loss and comprehensive loss | -- | -- | -- | -- | -- | -- | -- | (19,355) | -- | (19,355) |
| Balance at September 30, 1999 | 7,227,328 | $7 | 6,622,517 | $7 | 5,098,746 | $5 | $73,671 | $(19,355) | | |

| | | |
|---|---|---|
| Exercise of common stock options..... | -- | 388 |
| Compensation related to issuance of stock options and restricted common stock.... | (12,890) | -- |
| Amortization of stock-based compensation..... | 1,139 | 1,139 |
| Net loss and comprehensive loss..... | -- | (19,355) |
| Balance at September 30, 1999..... | $(11,751) | $ 42,584 |

See accompanying notes.

# *Pets.com, Inc.*

## STATEMENT OF CASH FLOWS (IN THOUSANDS) PERIOD FROM FEBRUARY 17, 1999 (INCEPTION) TO SEPTEMBER 30, 1999

| | |
|---|---|
| OPERATING ACTIVITIES | |
| Net loss..... | $(19,355) |
| Adjustments to reconcile net loss to net cash used in operating activities: | |
| Depreciation..... | 319 |
| Common and preferred stock issued for intellectual property..... | 416 |
| Amortization of stock-based compensation related to stock options..... | 1,139 |
| Changes in: | |
| Inventories..... | (1,872) |
| Prepaid marketing expenses..... | (2,214) |
| Other prepaid expenses and current assets..... | (411) |
| Certificate of deposit..... | (150) |
| Other assets..... | (272) |
| Accounts payable, accrued expenses and other..... | 5,815 |
| Net cash used in operating activities..... | (16,585) |
| INVESTING ACTIVITIES | |
| Purchase of fixed assets..... | (7,568) |
| Net cash used in investing activities..... | (7,568) |
| FINANCING ACTIVITIES | |
| Proceeds from issuances of common stock..... | 14 |
| Proceeds from exercise of stock options..... | 388 |
| Net proceeds from issuances of Series A preferred stock..... | 10,021 |
| Net proceeds from issuances of Series B preferred stock..... | 49,961 |
| Net cash provided by financing activities..... | 60,384 |
| Net increase in cash and cash equivalents..... | 36,231 |
| Cash and equivalents at beginning of period..... | -- |
| Cash and equivalents at end of period..... | $ 36,231 |

See accompanying notes.

# *Pets.com, Inc.*

## *Notes to Financial Statements September 30, 1999*

## *1. Summary of Significant Accounting Policies*

### *Description of Business*

Pets.com, Inc. (the Company) was formed on February 17, 1999 with the acquisition of certain assets and internet domain names. The Company is engaged in the sale over the Internet of pet products, services, and information primarily in the United States.

### *Fiscal Year*

The Company's fiscal year begins on January 1 and ends on December 31 of each year.

### *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

### *Revenue Recognition*

Revenues on product sales, net of discounts, coupons and allowances, are recognized upon shipment of the related goods. Outbound shipping and handling fees are included in net sales upon shipment. The Company provides for an estimated allowance for sales returns in the period of sale.

### *Product Development*

Product development expenses consist primarily of payroll and related expenses for Web site development, systems personnel, consultants, and other website costs. As the Company believes that its website is subject to continual and substantial change, expenditures relating to product development are expensed as incurred.

## *Advertising*

Advertising costs are expensed as incurred. Advertising expense was $7,634,000 for the period from February 17, 1999 (inception) to September 30, 1999, respectively.

## *Marketing Agreement*

In conjunction with the sale of its Series A preferred stock, the Company entered into a co-marketing agreement with a shareholder, which allows for certain reciprocal advertising, promotional and customer acquisition activities for an initial term of 18 months. Under the agreement, both the Company and the shareholder will reimburse each other in equal amounts for customers acquired as a result of the marketing agreement.

## *Cash Equivalents*

The Company considers all highly liquid investments with a maturity of three months or less at the date of purchase to be cash equivalents. The Company's cash equivalents consist mainly of money market funds.

# *Pets.com, Inc.*

# *Notes to Financial Statements (Continued) September 30, 1999*

# *1. Summary of Significant Accounting Policies (Continued) Inventories*

Inventories are stated at the lower of cost (using the first-in, first-out method) or market.

## *Certificate of Deposit*

The certificate of deposit is restricted and secures a letter of credit related to the Company's lease agreement (see Note 3). The carrying amount approximates fair value.

## *Fixed Assets*

Fixed assets are stated at cost less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the related assets, which range from three to seven years.

The Company capitalizes certain internal use software costs in accordance with Statement of Position 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Capitalized internal use software costs with an expected useful life in excess of one year are amortized on a straight-line basis over their estimated useful lives. Internal use software costs, which are subject to continual and substantial change, are expensed as incurred.

## *Long-lived Assets*

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability of assets is measured by comparison of the carrying amount of the asset to net future cash flows expected to be generated from the asset. No impairment has been recognized in the accompanying financial statements.

## *Net Loss Per Share*

Net loss per share is computed using the weighted-average number of shares of common stock outstanding less the number of shares subject to repurchase. Shares associated with stock options, warrants and the convertible preferred stock are not included in the calculation of diluted net loss per share because they are antidilutive. At September 30, 1999, there were 3,286,909 unvested or restricted common shares that are subject to repurchase and 901,000 stock options that were excluded from the computation of diluted net loss per share. If the Company had reported net income, the calculation of these per share amounts would have included the dilutive effect of these common stock equivalents using the treasury stock method.

## *Concentration of Credit Risk*

The Company is subject to concentrations of credit risk from its cash investments. The Company's credit risk is managed through monitoring the stability of the financial institutions utilized and diversification of its financial resources.

The Company's financial instruments consist of cash and cash equivalents. The fair value of all financial instruments approximates the carrying amount based on the current rate offered to the Company for similar instruments.

# *Pets.com, Inc.*

## *Notes to Financial Statements (Continued) September 30, 1999*

## *1. Summary of Significant Accounting Policies (Continued) Stock-based Compensation*

The Company has elected to follow Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25), and related interpretations, in accounting for its employee stock options rather than the alternative fair value accounting allowed by Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). APB No. 25 provides that the compensation expense relative to the Company's employee stock options is measured based on the intrinsic value of the stock option. SFAS No. 123 requires companies that continue to follow APB No. 25 to provide a pro forma disclosure of the impact of applying the fair value method of SFAS No. 123 (see Note 5).

## *Income Taxes*

The Company accounts for income taxes under the liability method. Under the liability method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to be recovered. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be realized.

## *Comprehensive Income*

The Company adopted SFAS No. 130, Reporting Comprehensive Income, which requires that all items that are recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The items of other comprehensive income that are typically required to be displayed are foreign currency items, minimum pension liability adjustments, and unrealized gains and losses on certain investments in debt and equity securities. There were no items of other comprehensive income in 1999.

## New Accounting Pronouncements

In June 1998, the FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 is effective for fiscal years beginning after June 15, 2000. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designed as part of a hedge transaction and, if it is, the type of hedge transaction. The Company does not expect that the adoption of SFAS No. 133 will have a material impact on its financial statements because the Company does not currently hold any derivative instruments.

# Pets.com, Inc.

# Notes to Financial Statements (Continued) September 30, 1999

## 2. Fixed Assets

Fixed assets at September 30, 1999 consists of the following:

(In thousands)

| | |
|---|---|
| Computers and equipment | $3,150 |
| Purchased software | 2,034 |
| Furniture and fixtures | 269 |
| Plant and equipment | 1,076 |
| Leasehold improvements | 1,039 |
| | 7,568 |
| Less accumulated depreciation | (319) |
| | $7,249 |

## 3. Lease Agreements

The Company leases its office and warehouse facilities under various operating leases, which call for fixed rental payments through 2011. The lease arrangements require letters of credit totaling $1,350,000, in the event the Company defaults on any of its lease payments. Provided the Company is not in default, the letters of credit shall be reduced over the terms of the leases. Total rent expense under operating leases for the period ended September 30, 1999 approximated $239,000.

Future minimum commitments under operating leases at September 30, 1999 are as follows:

(In thousands)

| | |
|---|---|
| 2000 | $ 1,380 |
| 2001 | 2,165 |

| | |
|---|---|
| 2002 | 1,940 |
| 2003 | 1,977 |
| 2004 | 2,021 |
| Thereafter | 9,820 |
| Total minimum lease payments | $19,303 |

## *4. Income Taxes*

There has been no provision for U.S. federal, U.S. state, or foreign income taxes for any period as the Company has incurred operating losses in all periods and for all jurisdictions.

The following is a reconciliation of the statutory federal income tax rate to the Company's effective income tax rate:

| | |
|---|---|
| Statutory federal income tax benefit | (34)% |
| State income tax benefit | (6) |
| Valuation allowance | 38 |
| Non-deductible stock-based compensation | 2 |
| Income tax provision | --% |

# *Pets.com, Inc.*

## *Notes to Financial Statements (Continued) September 30, 1999*

4. INCOME TAXES (CONTINUED) Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets are as follows:

(In thousands)

| | |
|---|---|
| Deferred tax assets: | |
| Net operating loss carryforward | $ 7,101 |
| Other temporary differences | 176 |
| Total deferred tax assets | 7,277 |
| Less valuation allowance | (7,277) |
| Net deferred tax assets | $ -- |

Net deferred tax assets have been fully offset by a valuation allowance due to a lack of operating history combined with risks and uncertainties surrounding the Company's ability to generate future taxable income. The valuation allowance increased by $7,277,000 for the period from February 17, 1999 (inception) to September 30, 1999.

As of September 30, 1999, the Company had net operating loss carryforwards for federal income tax purposes of approximately $17,752,000, which expire in the year 2019. The Company also had net operating loss carryforwards for state income tax purposes of approximately $17,752,000 expiring in the year 2007.

Utilization of the Company's net operating loss may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss before utilization.

# *5. Stockholders' Equity*

## *Convertible Preferred Stock*

In April 1999, the Company issued 7,227,328 shares of Series A preferred stock in a private placement offering in exchange for cash proceeds of $10,079,624 and rights to certain internet domain names valued at $400,001.

In connection with the issuance of the Series A preferred stock, the Articles of Incorporation were amended to increase the total authorized number of common shares to 25,000,000, and to authorize a series of preferred stock consisting of 7,500,000 shares.

In June 1999, the Company issued 6,622,517 shares of Series B preferred stock in a private placement offering in exchange for cash proceeds of $50,000,003. In connection with the issuance of the Series B preferred stock, the Articles of Incorporation were amended to increase the total authorized number of common shares to 30,000,000 and preferred shares to 14,127,328.

Each share of the Company's Series A and B preferred stock is convertible into one share of common stock at the option of the holder, subject to certain antidilution adjustments, in accordance with the conversion formula provided in the Company's Articles (currently on a 1:1 ratio). Outstanding preferred shares automatically convert into common stock at the option of the holder and upon the closing of an initial public offering of the Company's common stock in which gross proceeds exceed $10.0 million and minimum per share price equal or exceeds $10.00 per share. Holders of each share of preferred stock are entitled to the number of votes per share that would be equivalent to the number of shares of common

# *Pets.com, Inc.*

## *Notes to Financial Statements (Continued) September 30, 1999*

5. STOCKHOLDERS' EQUITY (CONTINUED) stock into which a share of preferred stock is convertible and are entitled to dividends in preference to common stock, if and when declared by the Board of Directors. The Company also granted the preferred stockholders certain registration rights and agreed not to carry out certain actions without prior approval of the holders of not less than two-

thirds of the outstanding preferred shares, voting together as a single class. As a condition to the Series A and B preferred stock agreements, one shareholder agreed to restrict its acquisitions of Company shares to no more than a 46% interest for a period of up to 4 years.

## *Common Stock*

Under certain conditions, 50,000 shares of common stock issued to the Company's founders are subject to repurchase at the greater of the price originally paid or the fair market value of the stock at the time of repurchase. The repurchase provisions expire at the earlier of 36 months from the issuance date of the common stock or an initial public offering of the Company.

On February 17, 1999, the Company issued 1,610,587 common shares, for total consideration of $16,106 to a former officer in exchange for certain tangible and intangible assets. In connection with subsequent upgrades to the Company's website, these costs were recorded to general and administrative expense in the accompanying statement of operations.

## *1999 Stock Plan*

Under the terms of the 1999 Stock Plan (the 1999 option plan), the Board of Directors may grant incentive and nonqualified stock options to employees, officers, directors, agents, consultants, and independent contractors of the Company. In connection with the introduction of the 1999 Stock Plan, 3,537,167 shares of common stock were reserved for future issuance. In June and September 1999, the Company increased the number of shares reserved for future issuance under such plan by a total of 660,742 shares. Generally, the Company grants stock options with exercise prices equal to the fair market value of the common stock on the date of grant, as determined by the Company's Board of Directors. Options generally vest over a four-year period and expire ten years from the date of grant. The 1999 option plan also contains a restricted stock purchase feature which provides the employee the opportunity to exercise their options immediately and vest over their employment period as set out in their stock option award. If the employee terminates before vesting, the Company may repurchase the unvested options at the original strike price.

A summary of stock option activity follows:

| | | OUTSTANDING OPTIONS | |
|---|---|---|---|
| | SHARES AVAILABLE FOR GRANT | NUMBER OF OPTIONS | WEIGHTED-AVERAGE EXERCISE PRICE |
| 1999 Plan introduction | 3,537,167 | -- | $ -- |
| Restricted stock award issued | (1,157,023) | -- | .01 |
| Additional authorization | 660,742 | -- | -- |
| Options granted | (3,080,636) | 3,080,636 | .33 |
| Options exercised | -- | (2,132,386) | .18 |
| Exercised shares repurchased | -- | (2,500) | .75 |
| Options canceled | 44,750 | (44,750) | .52 |
| Outstanding at September 30, 1999 | 5,000 | 901,000 | $.67 |

# *Pets.com, Inc.*

## *Notes to Financial Statements (Continued) September 30, 1999*

5. STOCKHOLDERS' EQUITY (CONTINUED) The following table summarizes information regarding stock options outstanding as of September 30, 1999:

| EXERCISE PRICE | NUMBER OF OPTIONS | WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE |
|---|---|---|
| $0.15 | 115,000 | 9.7 years |
| $0.75 | 786,000 | 9.9 years |
| $.15 - .75 | 901,000 | 9.9 years |

All of the remaining stock options are exercisable at September 30, 1999, but are subject to repurchase for the portion of options that have not yet vested. At September 30, 1999, none of the above employee option awards had reached their first vesting tranche.

For the period from February 17, 1999 (inception) to September 30, 1999, pro forma net loss and pro forma net loss per share were as follows:

(In thousands, except share amount) Net loss -- as reported..... $(19,355) Incremental pro forma compensation expense under SFAS No. 123..... (12) Net loss -- pro forma..... $(19,367) Net loss per share -- pro forma..... $ (10.84) The fair value of each option grant is estimated on the date of grant using the minimum value option pricing model, assuming no expected dividends and with the following weighted-average assumptions for the period ended September 30, 1999:

| | |
|---|---|
| Average risk-free interest rate..... | 6.3% |
| Average expected life..... | 7 years |
| Dividend yield..... | 0.0% |

For purposes of the pro forma disclosures, the per share weighted-average fair value of the options granted, estimated to be $0.11 at September 30, 1999, is amortized to expense over the options' vesting period. Compensation expense recognized in providing pro forma disclosures may not be representative of the effects on pro forma earnings for future years because the amounts above include only the amortization for the fair value of 1999 grants.

## *Common Stock Reserved for Future Issuance*

The following shares of common stock were reserved at September 30, 1999:

| | |
|---|---|
| Stock option plan..... | 906,000 |
| Conversion of Series A preferred stock..... | 7,227,328 |

| | |
|---|---|
| Conversion of Series B preferred stock..... | 6,622,517 |
| | 14,755,845 |

## *6. Legal Proceedings*

On September 2, 1999 Biolink LLC dba ERI International filed suit against the Company in Los Angeles County Superior Court for breach of contract, anticipatory breach of contract, breach of the F-13

# *Pets.com, Inc.*

# *Notes to Financial Statements (Continued) September 30, 1999*

6. LEGAL PROCEEDINGS (CONTINUED) implied covenant of good faith and fair dealing, and fraud arising out of a contract entered into for the shipment of live animals, including fish and reptiles. ERI International has stated four causes of action, three seeking damages each in an amount in excess of $2,000,000 and one cause of action seeking damages in an amount in excess of $500,000. The Company has answered and asserted affirmative defenses to their complaint. No trial date has been set and discovery has not yet commenced. The Company believes it has meritorious defenses to these claims and intends to vigorously defend against them. The Company believes that any liability that may ultimately result from the resolution of these matters will not have a material adverse effect on the Company's financial position, operating results, or cash flows.

From time to time, the Company is subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks and other intellectual property rights. The Company currently is not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on its business, prospects, financial condition and operating results.

## *7. Related-party Transactions*

In conjunction with the sale of its Series A preferred stock, the Company entered into a co-marketing agreement with a shareholder, which allows for certain reciprocal advertising, promotional and customer acquisition activities for an initial term of 18 months. Under the agreement, both the Company and the shareholder will pay each other in equal amounts for each customer acquired as a result of the marketing agreement.

In connection with the above mentioned sale of Series A preferred stock, the Company issued 275,863 Series A preferred shares with a total consideration of $400,001 to a former officer in exchange for certain internet domain names.

For the period from February 17, 1999 (inception) to September 30, 1999, a preferred stockholder provided legal services to the Company totaling approximately $153,000.

## 8. Subsequent Events

## Sale of Series B Convertible Preferred Stock

In November 1999 the Company issued 3,560,967 additional shares of Series B convertible preferred stock and notes payable totaling $7,384,708, in a private placement offering in exchange for cash proceeds of $34,270,008. The notes payable are conditionally convertible, depending on the structure of an anticipated second closing of the Series B offering.

In connection with the issuance of additional Series B convertible preferred stock, the Articles of Incorporation were amended to increase the total authorized number of common shares to 36,000,000, and authorized preferred stock to 21,427,328 shares, including authorization of 1,300,000 Series B-1 preferred non-voting shares.

In December 1999, the Company completed the second closing of the November 1999 Series B convertible preferred stock private placement offering. In conjunction with the closing, 1,986,756 shares of Series B convertible preferred stock were issued in exchange for cash proceeds of $15,000,008. An additional 978,107 shares of Series B convertible preferred stock were issued in connection with the conversion of the convertible notes payable issued at the initial closing.

## Pets.com, Inc.

## Notes to Financial Statements (Continued) September 30, 1999

## 8. Subsequent Events (Continued) Purchase of Interest in Company

In November 1999, the Company purchased 2,150,537 shares of Series A convertible preferred stock of PetPlace.com, Inc. for consideration of approximately $2.0 million. The Company is obligated to purchase an additional 1,612,903 shares of Series A convertible stock for approximately $1.5 million, by February 1, 2000, concurrent with the launch of PetPlace.com, Inc.'s Web site.

## *Proposed Initial Public Offering of Common Stock*

In December 1999, the board of directors authorized the Company to proceed with an initial public offering of its common stock. If the offering is consummated as presently anticipated, all of the outstanding shares of preferred stock will automatically convert into common stock upon the closing of the initial public offering.

In December 1999, the board of directors also approved, subject to stockholder approval, the reincorporation of the Company in Delaware, and a change in the number of authorized shares of 155,000,000 shares of which 150,000,000 will be common stock and 5,000,000 will be undesignated preferred stock.

## *1999 Stock Plan*

In December 1999, the board of directors increased the number of shares reserved under the 1999 stock plan by 2,000,000 shares. As of December 5, 1999, the Company has reserved a total of 7,269,159 shares of common stock under the 1999 plan, plus an evergreen provision which allows for an increase in the authorized number of shares on the first day of each of the fiscal years from 2001 to 2009, equal to the lesser of (i) 1,000,000 shares, (ii) 3% of the Company's outstanding common stock on the last day of the preceding fiscal year, or (iii) a lesser number of shares as determined by the board of directors.

## *2000 Employee Stock Purchase Plan*

In December 1999, the board of directors adopted the 2000 employee stock purchase plan, effective upon completion of the Company's initial offering of its common stock. A total number of 500,000 shares has been reserved for issuance under the employee stock purchase plan. The plan also contains an evergreen provision which allows for an annual increase in the authorized number of shares on the first day of each fiscal year from 2001 to 2010, equal to the lesser of (i) 300,000 shares, (ii) 1% of the Company's outstanding common stock on the last day of the preceding fiscal year, or (iii) a lesser number of shares as determined by the board of directors.

## *Defined Contribution Plan*

In October 1999, the Company adopted a defined contribution retirement plan under Section 401(k) of the Internal Revenue Code which covers substantially all employees. Eligible employees may contribute amounts to the plan, via payroll withholding, subject to certain limitations. Under the 401(k) plan, employees may elect to reduce their current compensation by up to the statutorily prescribed annual limit ($10,000 in 1999) and to have the amount of such reduction contributed to the 401(k) plan. The 401(k) plan permits, but does not require, additional matching contributions to the 401(k) plan by the Company on behalf of all participants in the plan.

# *[Description of Artwork]*

# *[Outside of Front Gatefold]*

Outside of the gatefold contains the Pets.com logo and the following text:

The Pets.com logo is located at the top of the page. A picture of the Pets.com sock puppet icon is located in the bottom right hand corner of the page. Above this graphic is the heading "Pets.com is committed to serving pets and their owners through products, information and services."

# *[Inside of Front Gatefold]*

The first page of the inside of the front gatefold contains "Pets.com" at the top of the page, with the sock puppet icon poking through to "O" in "Pets.com." The following text and pictures are located on the first page:

"Shopping and Selection" followed by pictures of some products carried by Pets.com and the Pets.complete branded product line. These pictures are described by the following text: We carry many product lines including bird cages, pet food, aquariums, pet collars and toys. We buy directly from manufacturers. In the first half of 2000, we plan to introduce our Pets.complete branded line."

"Shopping at our Web store" followed by a picture of Web site home page. This picture is described by the following text: "Our resource center offers databases with national and local information for pet owners. Consumers can instantly find special offers on featured products. Navigation by type of pet is simple and easy to use. Topical editorial helps consumers make purchase decisions." Each sentence of text is preceded by an asterisk leading to an arrow pointing to the highlighted feature on the screenshot of our Web store.

The second page of the inside of the front gatefold contains a picture of a woman and child sitting on a chair looking at a laptop computer screen with a dog sitting next to them. The following text and pictures are located on the second page:

A picture of a product category page on the Pets.com Web store showing a dog food bowl. The accompanying text describing the picture says "The shopping experience is based on how consumers actually shop. Virtual aisles let consumers move quickly to the product categories that interest them. Products are grouped the way consumers naturally think about them."

A picture of the product lines within a product category page on the Pets.com Web store showing types of dog food bowls available at. The accompanying text describing the picture says "A visual browsing experience makes it easy for consumers to find the product they're looking for."

A picture of an individual product page on the Pets.com Web store describing product information about a dog treat jar. The accompanying text describing he picture says "Product displays are large and clear, so consumers know what they're buying."

A picture of the ordering steps for Nutro Natural Choice Dry Dog Food with accompanying text stating "Simple steps will walk consumers through the ordering process." Each sentence of text is preceded by an asterisk leading to an arrow pointing to the highlighted feature on the screen shot of our Web store.

## *[Inside of Back Gatefold]*

The first page of the inside of the back gatefold contains the word "Information" with three pictures.

The first picture is of the Pets.com magazine with accompanying text describing the picture which says "The first issue of Pets.com, The Magazine for Pets and Their Humans was published in November 1999."

The second picture is of the Pets Vet column on the Pets.com Web store with accompanying text describing the picture which says "Web store features such as Pets Vet and Pets Law provide pet owners with professional advice - information to improve the lives of their pets. Experts on staff at Pets.com can help pet owners with questions on pet issues."

The third is a picture of the Pets Law column on the Pets.com Web store with accompanying text describing the picture which says "Within each article pet owners are referred to related products they can purchase to help their pets."

The second and third pictures have accompanying text describing the pictures which says "Topical articles on our Web store offer pet information authored by our contributing writers." Each sentence of text is preceded by an asterisk leading to an arrow pointing to the highlighted feature on the screen shot of our Web store.

The second page of the inside of the back gatefold contains the word "Community" with two pictures.

The first picture is of the message boards on the Pets.com Web store with accompanying text describing the picture which says "We also bring people together through online forums - a place for pet lovers to talk with each other about pet-related topics."

The second picture is of the Pets.commitment page on the Pets.com Web store with accompanying text describing the picture which says "We started Pets.commitment, a national program that contributes funds and encourages support for organizations devoted to people helping animals and animals helping people. For the year 2000, we have inaugurated the Heroes of Pets.commitment program to encourage volunteerism on behalf of animal organizations." Each sentence of text is preceded by an asterisk leading to an arrow pointing to the highlighted feature on the screen shot of our Web store.

The second page of the inside of back gatefold also contains the word "Service" with a picture of the Pets.com's distribution center and a picture of a customer service person with the following accompanying text describing the pictures: "We operate our own distribution and order fulfillment process through our 227,232 square foot distribution center in the San Francisco area. We own and manage our own customer service call center." Each sentence of text is preceded by an asterisk leading to an arrow pointing to the highlighted feature on the screen shot of our Web store.

## *[Outside of Back Gatefold]*

The outside page of the back gatefold contains a picture of the Pets.com sock puppet icon with four of our boxes and the following accompany text: "Meet the Pets.com Sock Puppet."

## *[Back Page of Prospectus]*

The outside page of the prospectus contains the Pets.com logo at the bottom of the page.

Through and including 2000 (the 25th day after the date of this prospectus), all dealers effecting transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

## *Shares*

## *Logo Common Stock*

## *Prospectus*

MERRILL LYNCH & CO. BEAR, STEARNS & CO. INC. THOMAS WEISEL PARTNERS LLC WARBURG DILLON READ LLC , 2000

## *Part Ii*

## *Information Not Required in Prospectus*

## *Item 13. Other Expenses of Issuance and Distribution*

The following table sets forth the costs and expenses, other than underwriting discounts and commissions, payable by Pets.com in connection with the sale of common stock being registered. All amounts are estimates except the SEC registration fee and the NASD filing fee and the Nasdaq National Market listing fee.

## *Amount to Be Paid*

| | |
|---|---|
| SEC registration fee | $ 26,400 |
| NASD filing fee | $ 10,500 |
| Nasdaq National Market listing fee | * |

| | |
|---|---|
| Printing and engraving expenses | * |
| Legal fees and expenses | * |
| Accounting fees and expenses | * |
| Blue Sky qualification fees and expenses | * |
| Transfer Agent and Registrar fees | * |
| Miscellaneous fees and expenses | * |
| Total | 1,000,000 |

* to be filed by amendment

# *Item 14. Indemnification of Directors and Officers*

Section 145 of the Delaware General Corporation Law (the "Delaware Law") authorizes a court to award, or a corporation's board of directors to grant, indemnity to directors and officers in terms sufficiently broad to permit such indemnification under certain circumstances for liabilities (including reimbursement for expenses incurred) arising under the Securities Act of 1933, as amended (the "Securities Act"). Article XII of our proposed Amended and Restated Certificate of Incorporation (Exhibit 3.2 hereto) and Article VI of our proposed Amended and Restated Bylaws (Exhibit 3.4 hereto) provide for indemnification of our directors, officers, employees and other agents to the maximum extent permitted by Delaware Law. In addition, we have entered into Indemnification Agreements (Exhibit 10.1 hereto) with our officers and directors. The U.S. Purchase Agreement (Exhibit 1.1) also provides for cross-indemnification among Pets.com and the Underwriters with respect to certain matters, including matters arising under the Securities Act.

# *Item 15. Recent Sales of Unregistered Securities*

Since our formation on February 17, 1999, we have issued and sold (without payment of any selling commission to any person) the following unregistered securities:

1. On March 10, 1999, we issued two convertible promissory notes in the principal amounts of $142,500 and $7,500 to two accredited investors. The notes were canceled and converted into shares of Series A preferred stock on April 22, 1999.

2. On March 19, 1999, we issued two convertible promissory notes in the principal amounts of $237,500 and $12,500 to two accredited investors. The notes were canceled and converted into shares of Series A preferred stock on April 22, 1999.

3. On April 22, 1999, we issued 7,227,328 shares of our Series A preferred stock to eight accredited investors for an aggregate cash consideration of $10,479,625.60, which included conversion of the convertible promissory notes described in items 1 and 2 above into a total of 277,127 shares of our Series A preferred stock (including conversion of accrued interest on the promissory notes).

4. On June 18, 1999, we issued 6,622,517 shares of our Series B preferred stock to nine accredited investors for an aggregate cash consideration of $50,000,003.35.

5. On November 5, 1999, we issued 3,560,967 shares of our Series B preferred stock for cash consideration of $26,885,300.85 to eight accredited investors; six convertible promissory notes in the aggregate principal amount of $4,409,592.60 to six accredited investors, which notes were cancelled and converted into 584,052 shares of our Series B preferred stock on December 8, 1999; and one convertible promissory note in the principal amount of $2,975,115.25 to one accredited investor, which note was cancelled and converted into 394,055 shares of our Series B preferred stock on December 8, 1999.

6. On December 8, 1999, we issued to a total of twenty-five accredited investors 2,964,863 shares of our Series B preferred stock for cash consideration of $15,000,007.80 and conversion of outstanding convertible promissory notes in the aggregate principal amount of $7,384,707.85.

7. As of December 9, 1999, an aggregate of approximately 5,693,246 shares of common stock had been issued upon exercise of options or pursuant to restricted stock purchase agreement and an aggregate of approximately 1,335,250 shares of common stock were issuable upon exercise of outstanding options under the registrant's stock plans.

The issuances of the above securities were deemed to be exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act as transactions by an issuer not involving any public offering. In addition, certain issuances described in Item 7 above were deemed exempt from registration under the Securities Act in reliance upon Rule 701 under the Securities Act. The recipients of securities in each such transaction represented their intentions to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof and appropriate legends were affixed to the share certificates and warrants issued in such transactions. All recipients had adequate access, through their relationships with us, to information about Pets.com.

## *Item 16. Exhibits and Financial Statement Schedules*

(a) EXHIBITS

## *Number Description*

| | |
|---|---|
| 1.1* | Form of U.S. Purchase Agreement. |
| 3.1 | Third Amended and Restated Articles of Incorporation of Pets.com. |
| 3.2 | Form of Certificate of Incorporation of Pets.com, to be filed and effective upon completion of this offering. |
| 3.3 | Bylaws of Pets.com, as amended. |
| 3.4 | Form of Bylaws of Pets.com, to be effective upon completion of this offering. |
| 4.1* | Form of Pets.com common stock certificate. |
| 5.1* | Opinion of Venture Law Group, a Professional Corporation. |
| 10.1 | Form of Indemnification Agreement between Pets.com and each of its officers and directors. |
| 10.2.1 | 1999 Stock Plan, as amended. |
| 10.2.2 | 2000 Employee Stock Purchase Plan. |
| 10.3 | Common Stock Purchase Agreement with Greg McLemore dated February 17, 1999. |

```
10.4     Restricted Stock Purchase Agreement dated March 10, 1999
         with Julia Wainwright.
10.5     Bill of Sale and Assignment with Greg McLemore and Koala
         Computer Products dated February 17, 1999.
10.6     Offer Letter dated March 4, 1999 with Julia L. Wainwright.
10.7     Offer Letter dated March 19, 1999 with Kathryn C. Ringewald.
10.8     Offer Letter dated March 24, 1999 with Christopher E. Deyo.
10.9     Offer Letter dated March 26, 1999 with John M. Hollon.
```

# *Number Description*

10.10 Offer Letter dated April 7, 1999 with Paul G. Melmon. 10.11 Offer Letter dated April 21, 1999 with John R. Benjamin. 10.12 Offer Letter dated April 22, 1999 with Diane R. Hourany. 10.13 Offer Letter dated May 4, 1999 with Sue Ann Latterman. 10.14 Offer Letter dated May 5, 1999 with John A. Hommeyer. 10.15 Offer Letter dated August 20, 1999 with Paul G. Manca. 10.16 Offer Letter dated November 15, 1999 with Ralph E. Lewis. 10.17 Series A Preferred Stock Purchase Agreement dated April 22, 1999. 10.18** Advertising Agreement with Amazon.com dated April 22, 1999. 10.19** Software License and Service Agreement with BroadVision, Inc. dated May 15, 1999. 10.20 Series B Preferred Stock Purchase Agreement dated June 18, 1999 10.21** License and Integration Agreement with Quality Software Systems, Inc. dated June 25, 1999. 10.22 PetPlace.com, Inc. Series A Preferred Stock Purchase Agreement dated November 12, 1999. 10.23 Series B Preferred Stock and Convertible Note Purchase Agreement dated November 5, 1999. 10.24 Amended and Restated Investors' Rights Agreement dated November 5, 1999. 10.25** Lease Agreement, as amended, with the Paulsen Family Partnership dated April 8, 1999 for offices at 435 Brannan Street, San Francisco, California. 10.26** Sublease Agreement, as amended, with National Distribution Agency, Inc. dated July 1, 1999 for a warehouse and distribution center at 33201 Dowe Avenue, Union City, California. 10.27** Lease Agreement with Bryant Springs L.L.C. dated September 20, 1999 for offices at 945 Bryant Street, San Francisco, California. 10.28** Lease Agreement with Rosenburg SOMA Investments IV, L.L.C. dated September 27, 1999 for a warehouse and distribution center at 150-160 King Street, San Francisco, California. 10.29 Lease Agreement with Whipple Properties 1001, L.L.C. dated November 5, 1999 for a warehouse and distribution center at 1035 Whipple Road, Hayward, California. 10.30** Lease Agreement with Precedent Industrial Group L.L.C. dated December 7, 1999, for a warehouse and distribution center at Building Number 1, Precedent South Business Center, Greenwood, Indiana. 10.31* Loan and Security Agreement with Paul Manca dated November, 1999. 21.1 List of Subsidiaries. 23.1 Consent of Independent Auditors 23.2* Consent of Counsel (included in Exhibit 5.1) 24.1 Power of Attorney (see page II-5) 27.1 Financial Data Schedule * To be supplied by amendment.

** Material has been omitted pursuant to a request for confidential treatment.

(b) FINANCIAL STATEMENT SCHEDULES Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements or notes thereto.

## *Item 17. Undertakings*

The undersigned registrant hereby undertakes to provide to the underwriters at the closing specified in the underwriting agreements certificates in such denominations and registered in such names as required by the underwriters to permit prompt delivery to each purchaser.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 (the "Act") may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act, and is, therefore, II-3 unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer, or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

The undersigned registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

## *Signatures*

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the city of San Francisco, State of California on December 9, 1999.

## *Pets.com, Inc.*

By: /s/ JULIA L. WAINWRIGHT Julia L. Wainwright, Chief Executive Officer

# *Power of Attorney*

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints, jointly and severally, Julia Wainwright and Paul Manca, and each of them, as his attorney-in-fact, with full power of substitution, for him in any and all capacities, to sign any and all amendments to this Registration Statement (including post-effective amendments), and any and all Registration Statements filed pursuant to Rule 462 under the Securities Act of 1933, as amended, in connection with or related to the offering contemplated by this Registration Statement and its amendments, if any, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming our signatures as they may be signed by our said attorney to any and all amendments to said Registration Statement.

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES ACT OF 1933, THIS REGISTRATION STATEMENT HAS BEEN SIGNED BY THE FOLLOWING PERSONS IN THE CAPACITIES AND ON THE DATES INDICATED:

# *Signature Title Date*

| | | |
|---|---|---|
| /s/ JULIA L. WAINWRIGHT<br>Julia L. Wainwright | Chief Executive Officer and Director | December 9, 1999 |

/s/ PAUL G. MANCA Chief Financial Officer December 9, 1999 Paul G. Manca /s/ JOHN B. BALOUSEK Director December 9, 1999 John B. Balousek /s/ MATTHEW T. COWAN Director December 9, 1999 Matthew T. Cowan /s/ JOHN R. HUMMER Director December 9, 1999 John R. Hummer /s/ RANDOLPH J. TINSLEY Director December 9, 1999 Randolph J. Tinsley

# *Index to Exhibits*

# *Number Description*

1.1* Form of U.S. Purchase Agreement. 3.1 Third Amended and Restated Articles of Incorporation of Pets.com. 3.2 Form of Certificate of Incorporation of Pets.com, to be filed and effective upon completion of this offering. 3.3 Bylaws of Pets.com, as amended. 3.4 Form of Bylaws of Pets.com, to be effective upon completion of this offering. 4.1* Form of Pets.com common stock certificate. 5.1* Opinion of Venture Law Group, a Professional Corporation. 10.1 Form of Indemnification Agreement between Pets.com and each of its officers and directors. 10.2.1 1999 Stock Plan, as amended. 10.2.2 2000 Employee Stock Purchase Plan. 10.3 Common Stock Purchase Agreement with Greg McLemore dated February 17, 1999. 10.4 Restricted Stock Purchase Agreement dated March 10, 1999 with Julia Wainwright. 10.5 Bill of Sale and Assignment with Greg McLemore and Koala Computer Products dated February 17, 1999. 10.6 Offer Letter dated March 4, 1999 with Julia L. Wainwright. 10.7 Offer

Letter dated March 19, 1999 with Kathryn C. Ringewald. 10.8 Offer Letter dated March 24, 1999 with Christopher E. Deyo. 10.9 Offer Letter dated March 26, 1999 with John M. Hollon. 10.10 Offer Letter dated April 7, 1999 with Paul G. Melmon. 10.11 Offer Letter dated April 21, 1999 with John R. Benjamin. 10.12 Offer Letter dated April 22, 1999 with Diane R. Hourany. 10.13 Offer Letter dated May 1, 1999 with Sue Ann Latterman. 10.14 Offer Letter dated May 5, 1999 with John A. Hommeyer. 10.15 Offer Letter dated August 20, 1999 with Paul G. Manca. 10.16 Offer Letter dated November 15, 1999 with Ralph E. Lewis. 10.17 Series A Preferred Stock Purchase Agreement dated April 22, 1999. 10.18** Advertising Agreement with Amazon.com dated April 22, 1999. 10.19** Software License and Service Agreement with BroadVision, Inc. dated May 15, 1999. 10.20 Series B Preferred Stock Purchase Agreement dated June 18, 1999 10.21** License and Integration Agreement with Quality Software Systems, Inc. dated June 25, 1999. 10.22 PetPlace.com, Inc. Series A Preferred Stock Purchase Agreement dated November 12, 1999. 10.23 Series B Preferred Stock and Convertible Note Purchase Agreement dated November 5, 1999. 10.24 Amended and Restated Investors' Rights Agreement dated November 5, 1999. 10.25** Lease Agreement, as amended, with the Paulsen Family Partnership dated April 8, 1999 for offices at 435 Brannan Street, San Francisco, California. 10.26** Sublease Agreement, as amended, with National Distribution Agency, Inc. dated July 1, 1999 for a warehouse and distribution center at 33201 Dowe Avenue, Union City, California. 10.27** Lease Agreement with Bryant Springs L.L.C. dated September 20, 1999 for offices at 945 Bryant Street, San Francisco, California. 10.28** Lease Agreement with Rosenburg SOMA Investments IV, L.L.C. dated September 27, 1999 for a warehouse and distribution center at 150-160 King Street, San Francisco, California. 10.29 Lease Agreement with Whipple Properties 1001, L.L.C. dated November 5, 1999 for a warehouse and distribution center at 1035 Whipple Road, Hayward, California. 10.30** Lease Agreement with Precedent Industrial Group L.L.C. dated December 7, 1999 for a warehouse and distribution center at Building Number 1, Precedent South Business Center, Greenwood, Indiana. 10.31* Loan and Security Agreement with Paul Manca dated November, 1999.

## *Number Description*

| | |
|---|---|
| 21.1 | List of Subsidiaries. |
| 23.1 | Consent of Independent Auditors |
| 23.2* | Consent of Counsel (included in Exhibit 5.1) |
| 24.1 | Power of Attorney (see page II-5) |
| 27.1 | Financial Data Schedule |

* To be supplied by amendment.

** Material has been omitted pursuant to a request for confidential treatment. </TEXT>