

m o v i n g   a h e a d



P E T s M A R T , I n c .   1 9 9 9   A n n u a l   R e p o r t



# Closer to the customer

**PETsMART, Inc.** PETsMART, Inc. is a leading retail supplier of pet food, supplies and complete veterinary, grooming and training services. The company operates more than 500 pet superstores in the United States and Canada, has a large pet supply and equine catalog business, and is a major investor in PETsMART.com, a leading pet e-commerce company.

**PETsMART Direct, Inc.** PETsMART Direct, a wholly owned subsidiary of PETsMART, Inc., provides direct marketing services for the corporation and order fulfillment for PETsMART.com. Through branded catalogs and its State Line Tack direct mail and e-commerce divisions, PETsMART Direct carries more than 50,000 pet and equine products.

**PETsMART Charities, Inc.** PETsMART Charities is a 501(c)3 organization dedicated to saving the lives of homeless and abandoned pets. Since 1992, PETsMART Charities has donated more than \$10 million to animal welfare programs and, through its “Luv-A-Pet” Adoption Centers in PETsMART stores, has saved the lives of more than 700,000 companion animals.

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## Strategic Investments

**PETsMART.com, Inc.** PETsMART.com is the Internet’s most popular pet-related consumer site. The site, which was developed in partnership with IdeaLab!, provides visitors with convenience, security and service. It features a broad range of merchandise, expert advice and community activities for consumers who care about pets. At the end of 1999, PETsMART, Inc. owned approximately 49 percent of the outstanding equity of PETsMART.com.

**Medical Management International** Medical Management International (MMI) is the world’s largest provider of veterinary services. The company operates full-service veterinary hospitals and wellness clinics inside PETsMART stores. MMI is an industry leader in “human” quality veterinary care, and has pioneered pet wellness programs and the world’s first pet insurance plans based on actuarial data. PETsMART owns approximately 36 percent of the outstanding equity of MMI.

# Moving ahead of the pack

## Financial Highlights

(In thousands, except per share amounts and store data)

	1999	1998	1997
<b>Total Results</b>			
Net sales	\$2,110,316	\$2,109,322	\$1,790,599
Operating income (loss)	\$ 41,100	\$ 59,064	\$ (35,828)
Net income (loss)	\$ (32,422)	\$ 23,269	\$ (34,430)
Earnings (loss) per share	\$ (0.28)	\$ 0.20	\$ (0.30)
Total stores	484	534	468
Sales per square foot	\$ 163	\$ 175	\$ 177
Inventories	\$ 377,298	\$ 336,058	\$ 317,547
Working capital	\$ 280,311	\$ 296,307	\$ 297,441
Total debt	\$ 276,544	\$ 296,205	\$ 278,761
<b>Comparable Results<sup>(a)</sup></b>			
Net sales <sup>(b)</sup>	\$2,110,316	\$1,903,854	\$1,623,018
Operating income <sup>(c)</sup>	\$ 86,769	\$ 65,547 <sup>(f)</sup>	\$ 38,320 <sup>(f)</sup>
Net income <sup>(g)</sup>	\$ 38,051 <sup>(d)(e)</sup>	\$ 26,391	\$ 16,094 <sup>(d)</sup>
Earnings per share <sup>(h)</sup>	\$ 0.33	\$ 0.23	\$ 0.14
Total stores	484	441	384
Sales per square foot <sup>(b)</sup>	\$ 163	\$ 160	\$ 159

(a) Comparable results reflect historical balances adjusted to exclude the loss on the sale of the United Kingdom (U.K.) subsidiary, the equity loss in PETSMART.com, certain restructuring and business integration charges and the cumulative effects of changes in accounting principles. Had these events not occurred, results may have differed.

(b) Excludes net sales of the U.K. subsidiary of \$205.5 million in 1998, \$167.6 million in 1997, and \$108.9 million in 1996. Results of operations and the loss resulting from the sale of the U.K. subsidiary in 1999 were classified as "loss on disposal of subsidiary" in the consolidated statements of operations.

(c) Excludes operating losses of the U.K. subsidiary of \$14.6 million in 1999, \$8.3 million in 1998, \$0.6 million in 1997, and \$1.9 million in 1996, as well as the loss of \$31.1 million resulting from the sale of the U.K. subsidiary in December 1999.

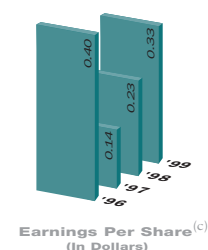
(d) Excludes the cumulative effect of a change in accounting principle of \$0.5 million in 1999, and \$2.6 million in 1997, net of income tax benefits.

(e) Excludes equity loss in PETSMART.com of \$29.1 million in 1999.

(f) Excludes credit to restructuring charges of \$1.8 million in 1998, as well as restructuring charges of \$16.1 million and merger and business integration charges of \$57.4 million in 1997. Restructuring charges in 1997 were recorded as components of cost of sales (\$9.4 million), store operating expenses (\$3.3 million) and general and administrative expenses (\$3.4 million).

(g) Excludes the results of operations and the loss on the sale of the U.K. subsidiary as discussed in Note "c" above, net of the related income tax benefit of \$4.8 million in 1999, \$5.7 million in 1998, and \$0.2 million in 1997. Excludes the items discussed in Note "f" above, net of income taxes (benefit) of \$0.7 million in 1998, and (\$26.2) million in 1997.

(h) Represents pro forma net income divided by weighted average shares outstanding on a diluted basis of 114,940 for 1999, 117,085 for 1998, and 114,920 for 1997.



May 1, 2000

Dear fellow shareholders:

## Our Vision

*PETsMART has the services and solutions to help you be a responsible pet owner by fulfilling the total lifetime needs of your pet.*

1999 was a watershed year for PETsMART. In the face of the many challenges that come with rebuilding a business, we maintained our company's fundamental strength and stability. We fortified our retail operations, reshaped our portfolio and, perhaps most importantly, we outlined a vision for the future – a vision we believe will translate into measurable value for our customers, our associates and our shareholders.

Operating income from our North American stores grew almost 39 percent over 1998, margins continued to improve, and comparable store sales increased 4.6 percent.

On a comparable basis, PETsMART's net income also grew, coming in at 33 cents per share, versus 23 cents last year, excluding the impact of losses from the operation and sale of our retail store subsidiary in the United Kingdom, and from our investment in PETsMART.com. While tough to face in the short term, these portfolio changes took an under-performing asset off the books and gave us another customer touch point via a strong and synergistic presence on the Web – both important investments in the future.

We also continued to invest in our infrastructure. Improvements to our supply chain began to come on line and early results show these changes have real power to reduce inventory and better our in-stock position over time. New information systems refined our operations, while our corporate brand program, unique retail mix and customer service initiatives drove traffic and sales.

Despite that ongoing stability and growth, and the completion of a \$25 million common stock purchase program, the PETsMART share price reached a low of \$2.63 in October 1999. The performance of our stock was our biggest disappointment and reflected a great deal of change in our industry.

During 1999, discounters and grocery stores began to offer a broader range of specialty items, including premium pet foods and expanded pet supplies. Consumers grew increasingly savvy and the pace of change intensified, presenting new challenges and significant opportunities for retailers.

In this environment, only companies that understand how to capitalize on change will win. PETsMART plans to be one of them.



(front row—left to right):

**Philip L. Francis**  
Chairman, President and CEO

**Robert F. Moran**  
President, North American Stores

(back row—left to right):

**Scott A. Crozier**  
Senior Vice President and General Counsel

**Neil T. Watanabe**  
Executive Vice President and CFO

**Marcia R. Meyer**  
President, PETsMART International  
Supply Company

# identify



Most analysts estimate the size of the annual market for basic pet products and services at about \$31 billion. At PETsMART, we see it differently. If you look at the total lifetime needs of pets – things like adoption, nutrition, health and medical care, shelter, and pet and owner education and entertainment – the market grows substantially. PETsMART is in a much stronger position than any other retailer to capitalize on that potential.

Our vision for our company and our future is simple, powerful and achievable: PETsMART will be the preferred provider for the lifetime needs of pets.

To make that vision a reality, we must reshape our business. Our customers, and what they want, show us the way.

PETsMART has identified a large segment of customers we call the “pet enthusiast.” This group is passionately committed to their pets, and to serve them, we must be just as passionate. We must nourish the pet enthusiasts’ relationships with their pets. We must provide solutions, expert advice, and an environment that enhances and facilitates the bond between pets and people. PETsMART has the experience and basic infrastructure to do these things well.

Better yet, we have found that creating value for the pet enthusiast allows us to capture important secondary customer segments and achieve a large share of the best customers using a single investment strategy.

*“Over the next three years, we will align each aspect of our business with the needs, desires and aspirations of the pet enthusiast.”*

# connect



Over the next three years, we will align each aspect of our business with the needs, desires and aspirations of the pet enthusiast.

**Product selection** The pet enthusiast – not our suppliers – now drives merchandise management. This dramatic shift represents our single biggest opportunity to lower costs and at the same time, give customers the value and the products they want throughout the lives of their pets.

From there, we will move into category management, where everything we do, from the structure of the organization to our business processes, is built around how our customers shop.

**Professional services** No other retailer can match the scale of grooming, pet training and veterinary services currently offered by PETsMART. In 2000, we plan to develop these core services to their full potential.

Strong professional pet services are required to fulfill the lifetime needs of pets. They help customers find solutions and expert advice. They provide multiple touch points with customers, encourage destination shopping and position PETsMART as the authority in pet care. We believe that, when fully developed, our core services will be an engine of profit and growth. Then, we plan to go after new, breakthrough services that will further set us apart.

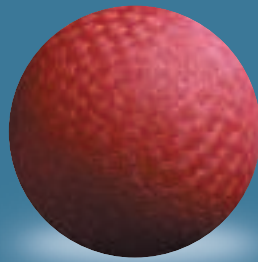
**Customer service** To win, PETsMART must change its focus from the tasks we accomplish to the customers we serve. We are tapping into the passion and expertise of our 21,000 associates to make PETsMART a customer-centered, sales-focused company. Our substantial investment in our people will pay dividends in the form of better convenience, information and service for our customers and a sustained competitive advantage for our shareholders.

**Customer experience** In PETsMART stores, customers can shop with their pets, adopt a homeless animal and watch grooming and pet training in action. We are building on those unique strengths to create the pet-caring atmosphere our customers crave, make PETsMART stores more fun to shop, enhance sales productivity and reinforce the strong PETsMART brand.

**Loyalty** By keeping the promises we make to customers, we earn the right to serve them for a lifetime. Our singular focus is meeting our customers' needs – spoken and unspoken – every time we interact with them. In the next year, we will develop a targeted loyalty program that supports our relationship with our best customers.

*“Our vision for our company and our future is simple, powerful and achievable: PETsMART will be the preferred provider for the lifetime needs of pets.”*

# perform



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Getting to the vision is a journey – one that starts with strengthening the core of our business. We gained ground in 1999 with successful behind-the-scenes work to build a solid infrastructure. In 2000, we will drive operating excellence in every core business practice that touches the pet enthusiast customer.

By the end of this year, we will:

- Enhance the pet-caring, customer-focused atmosphere in our stores. Our associates will greet every customer. They will gain and actively share extensive product and service knowledge and focus on convenience.
- Make sure the items customers want are in stock.
- Grow grooming and pet training sales. We will treat our services business with a start-up mentality, making substantial investments to drive rapid, profitable growth.
- Boost premium and corporate brand sales. We will encourage customers to move from grocery to premium food and supplies, and continue to offer excellent value through our own brands.
- Manage our costs aggressively, driving operating expenses down and maintaining an extremely competitive price and value position.
- Drive a culture of excellence. We will create rigorous operating procedures and key performance indicators, develop business-driven information systems that provide the data we need to make sound decisions, and share best practices chain wide.



# succeed



Success in developing our core businesses gives us the foundation. From there, we will continue the journey toward realizing our vision, expanding the core to fulfill the needs of our best customers and to create new demand.

Achieving these goals will fundamentally change the way PETsMART does business. The vision shifts our focus from transactions to relationships. It makes us a trusted authority, rather than simply a seller of goods. And ultimately, it builds the brand, making PETsMART not just a place to shop, but the ultimate symbol of caring for pets.

By creating a new kind of company, PETsMART will move ahead of the pack and be extremely difficult to catch. We will be the kind of company that exploits, rather than reacts to market turbulence. As the preferred provider for the lifetime needs of pets, we will create significant and sustainable value.

*Philip L. Francis*

Philip L. Francis  
Chairman, President and CEO

*“The vision shifts our  
focus from transactions  
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# Fulfilling the needs of a lifetime

From the moment a pet joins a family, PETsMART is there, providing the products, services and solutions to nourish successful relationships and build powerful bonds between pets and people.

## **Creating unique and exclusive products**

PETsMART has the industry's broadest line of products for every stage of a pet's life.

Our strength lies in creating innovative pet products, a capability that separates PETsMART from any other retailer. In 1999, our corporate brand program generated many of these breakthroughs.

PETsMART Premier Oven-Baked® dog food is more nutritious and better tasting than other premium brands because it is baked, rather than extruded and coated with fatty substances. Launched in January 2000, Premier is selling extremely well, even without wide-scale advertising.

Another industry first is Shareables. Recognizing that people often share their food with pets, PETsMART developed the Shareables line of snacks to be healthy and good tasting for both. We believe Oops!®, a plastic-backed paper towel for cleaning pet accidents, is another first-of-its-kind product with strong cross-over appeal.

In 2000, we will build on the success of these products with new offerings such as "Toy Shoppe"—a concept that brands our own line of toys and has significant customer appeal.

PETsMART offers each of these exclusive products and product lines at substantial value, a proposition supported by our solid relationships with suppliers around the world, cost-control initiatives and a double-the-difference price guarantee.

### **Providing services and solutions**

Our ability to participate in the bond between pets and people makes PETsMART different, and nowhere is that difference more visible than in the professional services we offer.

Through partnerships with local humane organizations, we make pets available for adoption in every PETsMART store, meaning the customer's bond with PETsMART can begin the moment a pet joins the family.

Pet training classes, from basic puppy to adult obedience, help pets stay in families and out of shelters by teaching them appropriate behaviors. In 2000, we are taking bold steps to strengthen and expand training, with the goal of becoming the industry leader.

PETsMART already is the nation's largest provider of professional pet grooming, and we continue to develop this piece of our business. This year, PETsMART signed an agreement with the Nash and Paragon schools – the “Ivy League” of grooming – to provide training for all our pet stylists, ensuring consistent quality and service at all PETsMART salons.

Through our unique partnership with Medical Management International (MMI), PETsMART provides full-service veterinary care. MMI is an industry pioneer, applying standards for “human” care to pets and managing pet care through wellness and insurance programs. These high standards for quality, combined with convenient locations inside our stores, increase the likelihood that pet owners will seek veterinary care and give PETsMART another touch point with our customers.

### **Building customer loyalty**

Relying on a single company to serve all the needs of a family member takes trust. PETsMART is building that trust—and a large share of loyal customers—in a number of ways.

Most important, we are making substantial investments in our people. In July 1999, the PETsMART Learning Institute opened its doors. This activity-based training program gives associates the skills and expertise to forge positive relationships with customers, and to become the source for information and advice. Our compensation system is built on rewarding performance in this area.

Operationally, we made strides in attracting and keeping the best customers. Our Universal Return Program, for example, allows consumers to return pet items purchased from *any* retail store, catalog or Web site to PETsMART stores for a refund, store credit or exchange. The policy brings luxury service to our value-based business, capitalizes on the synergy of our “bricks and clicks” model and drives traffic and sales.

Going forward, we will develop programs that allow us to gain a detailed understanding of our customers and build loyalty with offerings specifically targeted to their needs, habits and patterns.

**Promoting responsible ownership**

There are reasons PETsMART is so actively involved in saving the lives of homeless pets – 7 million of them. That is the estimated number of cats and dogs euthanized in the United States each year, simply because they do not have homes.

When our founders began this business, they made the decision not to sell cats or dogs, but to donate space in stores where local humane organizations could encourage thoughtful pet adoption by our customers. That commitment remains at the heart of our business. To date, the Luv-A-Pet adoption program has saved the lives of more than 700,000 homeless pets, and we expect to reach the 1 million mark in early 2001.

PETsMART Charities also contributes to the cause. Since 1994, the non-profit group has donated more than \$10 million to animal welfare organizations. Much of that support comes from PETsMART store associates, who actively encourage pet adoption, raise money through in-store promotions and last year, contributed more than \$500,000 through a voluntary payroll deduction program. The funding not only supports pet adoption, but also encourages spaying and neutering and educates people about responsible pet ownership.

At PETsMART, we are proud of the work we are doing to save lives and feel fortunate to be part of a business with such power to create meaningful change in the lives of pets and their people.



We're moving ahead

## Directors and Officers

### Directors

Norman E. Brinker  
*Chairman of the Board*  
Brinker International

Thierry Defforey  
*Independent Fund Manager*

Lawrence A. Del Santo  
*Retired President and  
Chief Executive Officer*  
Von's Supermarket  
Companies, Inc.

Jane Evans  
*President and Chief  
Executive Officer*  
Gamut Interactive

Philip L. Francis  
*Chairman, President and  
Chief Executive Officer*  
PETsMART, Inc.

Richard K. Lochridge  
*President and Chief  
Executive Officer*  
Lochridge & Company, Inc.

Barbara A. Munder  
*Senior Vice President,  
New Initiatives*  
The McGraw-Hill Companies

Walter J. Salmon  
*Stanley Roth Senior Professor  
of Retailing*  
Harvard University  
Business School

Thomas G. Stemberg  
*Chairman of the Board of  
Directors and Chief  
Executive Officer*  
Staples, Inc.

### Executive Officers

Philip L. Francis  
*Chairman, President and  
Chief Executive Officer*

Robert F. Moran  
*President,  
North American Stores*

Neil T. Watanabe  
*Executive Vice President and  
Chief Financial Officer*

Kenneth A. Banks  
*Senior Vice President,  
Marketing, Branding and  
Advertising*

Carol M. Cox  
*Senior Vice President,  
Human Resources*

Scott A. Crozier  
*Senior Vice President and  
General Counsel*

David L. King  
*Senior Vice President and  
Chief Information Officer*

Marcia R. Meyer  
*President, PETsMART  
International Supply  
Company*

Philip B. Murphy  
*Senior Vice President and  
General Manager, Services*

Neil H. Stacey  
*Senior Vice President,  
Consumables Merchandising*

Timothy N. Troy  
*Senior Vice President,  
Logistics and Distribution*

Anthony N. Truesdale  
*Senior Vice President, Hard  
Goods Merchandising*

James T. Walsh  
*Senior Vice President,  
Store Operations*

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**Investor Information Line**  
623-587-2025

**PETsMART Common Stock**  
The company's common stock  
is traded on the NASDAQ  
National Market under the  
symbol "PETM."

**Annual Meeting**  
The Annual Meeting of  
Stockholders of PETsMART,  
Inc. will be held on June 22,  
2000, at 10:00 a.m. at the  
Boston Marriott Longwharf,  
296 State Street,  
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