PETMED EXPRESS INC
Form 10-Q
October 31, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____________ to _____________

Commission file number: 000-28827

PETMED EXPRESS, INC.
(Exact name of registrant as specified in its charter)

FLORIDA	65-0680967
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1441 S.W. 29th Avenue, Pompano Beach, Florida33069
(Address of principal executive offices, including zip code)

(954) 979-5995
(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes S No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes S No £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer (Do not check if smaller reporting company)	o	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (defined in Rule 12b-2 of the Exchange Act).
Yes £ No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 20,006,773 Common Shares, $.001 par value per share at October 30, 2012.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

PETMED EXPRESS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	September 30, 2012 (Unaudited)	March 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$47,041	$46,801
Short term investments - available for sale	15,425	10,347
Accounts receivable, less allowance for doubtful accounts of $6 and $5, respectively	1,888	1,572
Inventories - finished goods	19,590	26,217
Prepaid expenses and other current assets	1,047	1,241
Deferred tax assets	852	1,230
Prepaid income taxes	349	199
Total current assets	86,192	87,607
Property and equipment, net	2,311	2,597
Intangible asset	860	860
Total assets	$89,363	$91,064
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$6,956	$6,619
Accrued expenses and other current liabilities	2,067	2,772
Total current liabilities	9,023	9,391
Deferred tax liabilities	227	492
Total liabilities	9,250	9,883
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $.001 par value, 5,000 shares authorized; 3 convertible shares issued and outstanding with a liquidation preference of $4 per share	9	9
Common stock, $.001 par value, 40,000 shares authorized; 20,007 and 20,338 shares issued and outstanding, respectively	20	20

Retained earnings	80,015	81,108
Accumulated other comprehensive gain	69	44
Total shareholders' equity	80,113	81,181
Total liabilities and shareholders' equity	$ 89,363	$ 91,064

See accompanying notes to condensed consolidated financial statements.

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PETMED EXPRESS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In thousands, except for per share amounts)(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2012	2011	2012	2011
Sales	$58,145	$58,225	$127,100	$131,803
Cost of sales	38,775	38,291	85,426	87,759
Gross profit	19,370	19,934	41,674	44,044
Operating expenses:				
General and administrative	5,371	5,604	11,293	11,708
Advertising	7,424	7,904	17,274	18,004
Depreciation	249	346	577	687
Total operating expenses	13,044	13,854	29,144	30,399
Income from operations	6,326	6,080	12,530	13,645
Other income:				
Interest income, net	64	72	123	158
Other, net	-	64	-	63
Total other income	64	136	123	221
Income before provision for income taxes	6,390	6,216	12,653	13,866
Provision for income taxes	2,356	2,286	4,667	5,099
Net income	$4,034	$3,930	$7,986	$8,767
Net income per common share:				
Basic	$0.20	$0.19	$0.40	$0.41
Diluted	$0.20	$0.19	$0.40	$0.41
Weighted average number of common shares outstanding:				
Basic	19,962	20,642	20,040	21,142
Diluted	20,062	20,710	20,154	21,238
Comprehensive income	$4,050	$3,979	$8,011	$8,909
Cash dividends declared per common share	$0.150	$0.125	$0.300	$0.250

See accompanying notes to condensed consolidated financial statements.

PETMED EXPRESS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)(Unaudited)

	Six Months Ended September 30, 2012	Six Months Ended September 30, 2011
Cash flows from operating activities:		
Net income	$7,986	$8,767
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	577	687
Share based compensation	1,039	1,127
Deferred income taxes	113	114
Bad debt expense	27	25
(Increase) decrease in operating assets and increase (decrease) in liabilities:		
Accounts receivable	(343)	527
Inventories - finished goods	6,627	6,026
Prepaid income taxes	(150)	(26)
Prepaid expenses and other current assets	194	(923)
Accounts payable	337	86
Accrued expenses and other current liabilities	(673)	(215)
Net cash provided by operating activities	15,734	16,195
Cash flows from investing activities:		
Net change in investments	(5,053)	9,693
Purchases of property and equipment	(291)	(293)
Net cash (used in) provided by investing activities	(5,344)	9,400
Cash flows from financing activities:		
Dividends paid	(6,117)	(5,404)
Purchases of treasury stock	(3,865)	(22,642)
Tax adjustment related to restricted stock	(168)	(71)
Net cash used in financing activities	(10,150)	(28,117)
Net increase (decrease) in cash and cash equivalents	240	(2,522)
Cash and cash equivalents, at beginning of period	46,801	49,660
Cash and cash equivalents, at end of period	$47,041	$47,138
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$4,872	$5,083
Dividends payable in accrued expenses	$136	$135

See accompanying notes to condensed consolidated financial statements.

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PETMED EXPRESS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: Summary of Significant Accounting Policies

Organization

PetMed Express, Inc. and subsidiaries, d/b/a 1-800-PetMeds (the "Company"), is a leading nationwide pet pharmacy. The Company markets prescription and non-prescription pet medications, health products, and pet supplies for dogs and cats direct to the consumer. The Company offers consumers an attractive alternative for obtaining pet medications in terms of convenience, price, and speed of delivery. The Company markets its products through national television, online, and direct mail/print advertising campaigns, which aim to increase the recognition of the "1-800-PetMeds" brand name, and "PetMeds" family of trademarks, increase traffic on its website at www.1800petmeds.com, acquire new customers, and maximize repeat purchases. The majority of the Company's sales are to residents in the United States. The Company's executive offices are located in Pompano Beach, Florida. The Company's fiscal year end is March 31, and references herein to Fiscal 2013 or 2012 refer to the Company's fiscal years ending March 31, 2013 and 2012, respectively.

Basis of Presentation and Consolidation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, the accompanying Condensed Consolidated Financial Statements contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position of the Company at September 30, 2012, the Statements of Income and Comprehensive Income for the three and six months ended September 30, 2012 and 2011, and Cash Flows for the six months ended September 30, 2012 and 2011. The results of operations for the three and six months ended September 30, 2012 are not necessarily indicative of the operating results expected for the fiscal year ending March 31, 2013. These financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's annual report on Form 10-K for the fiscal year ended March 31, 2012. The Condensed Consolidated Financial Statements include the accounts of PetMed Express, Inc. and its wholly owned subsidiaries. All significant intercompany transactions have been eliminated upon consolidation.

Use of Estimates

The preparation of Condensed Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value of Financial Instruments

The carrying amounts of the Company's cash and cash equivalents, short term investments, accounts receivable, and accounts payable approximate fair value due to the short-term nature of these instruments. The Company believes that the carrying amount of its long term investments approximate fair value.

Recent Accounting Pronouncements

The Company does not believe that any recently issued, but not yet effective, accounting standards, if currently adopted, will have a material effect on the Company’s consolidated financial position, results of operations, or cash flows.

Note 2: Net Income Per Share

In accordance with the provisions of ASC Topic 260 (“Earnings Per Share”) basic net income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income per common share includes the dilutive effect of potential restricted stock and the effects of the potential conversion of preferred shares, calculated using the treasury stock method. Outstanding stock options and convertible preferred shares issued by the Company represent the only dilutive effect reflected in diluted weighted average shares outstanding.

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the periods presented (in thousands, except for per share amounts):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2012	2011	2012	2011
Net income (numerator):				
Net income	$ 4,034	$ 3,930	$ 7,986	$ 8,767
Shares (denominator):				
Weighted average number of common shares outstanding used in basic computation	19,962	20,642	20,040	21,142
Common shares issuable upon the vesting of restricted stock	90	58	104	86
Common shares issuable upon conversion of preferred shares	10	10	10	10
Shares used in diluted computation	20,062	20,710	20,154	21,238
Net income per common share:				
Basic	$ 0.20	$ 0.19	$ 0.40	$ 0.41
Diluted	$ 0.20	$ 0.19	$ 0.40	$ 0.41

At September 30, 2012 and 2011, all common restricted stock were included in the diluted net income per common share computation.

Note 3: Accounting for Stock-Based Compensation

The Company records compensation expense associated with restricted stock in accordance with ASC Topic 718 (“Share Based Payment”). The Company adopted the modified prospective transition method provided under ASC Topic 718. The compensation expense related to all of the Company’s stock-based compensation arrangements is recorded as a component of general and administrative expenses.

The Company had 578,127 restricted common shares issued under the 2006 Employee Equity Compensation Restricted Stock Plan (“Employee Plan”) and 182,000 restricted common shares issued under the 2006 Outside Director Equity Compensation Restricted Stock Plan (“Director Plan”) at September 30, 2012, all shares of which were issued subject to a restriction or forfeiture period which lapse ratably on the first, second, and third anniversaries of the date of grant, and the fair value of which is being amortized over the three-year restriction period. In July 2012 the Board of Directors approved the issuance of approximately 87,000 restricted shares to certain employees and the outside directors of the Company. For the quarters ended September 30, 2012 and 2011, the Company recognized $485,000 and $561,000, respectively, of compensation expense related to the Employee and Director Plans. For the six months ended September 30, 2012 and 2011, the Company recognized $1.0 million and $1.1 million, respectively, of compensation expense related to the Employee and Director Plans. At September 30, 2012 and 2011, there was $2.0 million and $3.6 million of unrecognized compensation cost related to the non-vested restricted stock awards, respectively, which is expected to be recognized over the next three years.

Note 4: Short Term Investments

The Company's short term investments balance consists of short term bond mutual funds. In accordance with ASC Topic 320 ("Accounting for Certain Investments in Debt and Equity Securities"), short term investments are accounted for as available for sale securities with any changes in fair value to be reflected in other comprehensive income. The Company had a short term investments balance of $15.4 and $10.3 million as of September 30, 2012 and March 31, 2012, respectively.

Note 5: Fair Value

The Company carries various assets and liabilities at fair value in the Condensed Consolidated Balance Sheets. Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. ASC Topic 820 ("Fair Value Measurements") establishes a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2 - Include other inputs that are directly or indirectly observable in the marketplace.
Level 3 - Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company's cash equivalents and short term investments are classified within Level 1. Assets and liabilities measured at fair value are summarized below:

		Fair Value Measurement at September 30, 2012 Using		
(In thousands)	September 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents - money market funds	$47,041	$47,041	$-	$ -
Short term investments - bond mutual funds	15,425	15,425	-	-
	$62,466	$62,466	$-	$ -

Note 6: Commitments and Contingencies

The Company has settled complaints that had been filed with various states' pharmacy boards in the past. There can be no assurances made that other states will not attempt to take similar actions against the Company in the future. The Company initiates litigation to protect its trade or service marks. There can be no assurance that the Company will be successful in protecting its trade or service marks. Legal costs related to the above matters are expensed as incurred.

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Note 7: Changes in Stockholders' Equity and Comprehensive Income:

Changes in stockholders' equity for the six months ended September 30, 2012 are summarized below (in thousands):

	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Gain
Beginning balance at March 31, 2012:	$-	$81,108	$ 44
Share based compensation	1,039	-	-
Dividends declared	-	(6,085)	-
Net income	-	7,986	-
Repurchased and retired shares	(3,865)	-	-
Deffered tax adjustment related to resticted stock	(168)	-	-
Allocation of retirement of additional paid in capital and retained earnings	2,994	(2,994)	-
Net change in unrealized gain on short term investments	-	-	25
Ending balance at September 30, 2012:	$-	$80,015	$ 69

Shares of treasury stock purchased in the six months ended September 30, 2012 totaling 397,000 were retired and cancelled, and 894,000 shares of treasury stock were purchased and retired in the six months ended September 30, 2011.

Total comprehensive income for the three and six months ended September 30, 2012 and 2011 is summarized below (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2012	2011	2012	2011
Net income	$4,034	$3,930	$7,986	$8,767
Net change in unrealized gain on short term investments	16	22	25	68
Net change in unrealized gain on redemptions of long term investments	-	27	-	74
Comprehensive income	$4,050	$3,979	$8,011	$8,909

Note 8: Income Taxes

For the quarters ended September 30, 2012 and 2011, the Company recorded an income tax provision for approximately $2.4 million and $2.3 million, respectively. For the six months ended September 30, 2012 and 2011, the Company recorded an income tax provision for approximately $4.7 million and $5.1 million, respectively. The effective tax rate for the six months ended September 30, 2012 and 2011 was 36.9% and 36.8%, respectively.

Note 9: Subsequent Events

On October 26, 2012 our Board of Directors declared a quarterly dividend of $0.15 per share. The Board established a November 9, 2012 record date and a November 23, 2012 payment date. Based on the outstanding share balance as of October 30, 2012 the Company estimates the dividend payable to be approximately $3.0 million.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Executive Summary

PetMed Express was incorporated in the state of Florida in January 1996. The Company's common stock is traded on the NASDAQ Global Select Market under the symbol "PETS." The Company began selling pet medications and other pet health products in September 1996. In March 2010 the Company started offering for sale additional pet supplies on its website, and these items are drop shipped to customers by third party vendors. Presently, the Company's product line includes approximately 1,600 of the most popular pet medications, health products, and supplies for dogs and cats.

The Company markets its products through national television, online, and direct mail/print advertising campaigns which aim to increase the recognition of the "1-800-PetMeds" brand name, and "PetMeds" family of trademarks, increase traffic on its website at www.1800petmeds.com, acquire new customers, and maximize repeat purchases. Approximately 77% of all sales were generated via the Internet for the quarter ended September 30, 2012, compared to 74% for the quarter ended September 30, 2011. The Company's sales consist of products sold mainly to retail consumers. The three-month average purchase was approximately $72 and $76 per order for the quarters ended September 30, 2012 and 2011, respectively, and the six-month average purchase was approximately $73 and $78 per order for the period ended September 30, 2012 and 2011, respectively.

Critical Accounting Policies

Our discussion and analysis of our financial condition and the results of our operations are based upon our Consolidated Financial Statements and the data used to prepare them. The Company's Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America. On an ongoing basis we re-evaluate our judgments and estimates including those related to product returns, bad debts, inventories, long term investments, and income taxes. We base our estimates and judgments on our historical experience, knowledge of current conditions, and our beliefs of what could occur in the future considering available information. Actual results may differ from these estimates under different assumptions or conditions. Our estimates are guided by observing the following critical accounting policies.

Revenue recognition

The Company generates revenue by selling pet medication products and pet supplies primarily to retail consumers. The Company's policy is to recognize revenue from product sales upon shipment, when the rights of ownership and risk of loss have passed to the customer. Outbound shipping and handling fees are included in sales and are billed upon shipment. Shipping expenses are included in cost of sales. The majority of the Company's sales are paid by credit cards and the Company usually receives the cash settlement in two to three banking days. Credit card sales minimize accounts receivable balances relative to sales. The Company maintains an allowance for doubtful accounts for losses that the Company estimates will arise from customers' inability to make required payments, arising from either credit card charge-backs or insufficient funds checks. The Company determines its estimates of the uncollectibility of accounts receivable by analyzing historical bad debts and current economic trends. The allowance for doubtful accounts was approximately $6,000 at September 30, 2012 compared to $5,000 at March 31, 2012.

Valuation of inventory

Inventories consist of prescription and non-prescription pet medications and pet supplies that are available for sale and are priced at the lower of cost or market value using a weighted average cost method. The Company writes down its inventory for estimated obsolescence. The inventory reserve was approximately $49,000 at September 30, 2012 compared to $66,000 at March 31, 2012.

Advertising

The Company's advertising expense consists primarily of television advertising, Internet marketing, and direct mail/print advertising. Television advertising costs are expensed as the advertisements are televised. Internet costs are expensed in the month incurred and direct mail/print advertising costs are expensed when the related catalogs, brochures, and postcards are produced, distributed, or superseded.

Accounting for income taxes

The Company accounts for income taxes under the provisions of ASC Topic 740 (“Accounting for Income Taxes”), which generally requires recognition of deferred tax assets and liabilities for the expected future tax benefits or consequences of events that have been included in the Consolidated Financial Statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting carrying values and the tax bases of assets and liabilities, and are measured by applying enacted tax rates and laws for the taxable years in which those differences are expected to reverse.

Results of Operations

The following should be read in conjunction with the Company’s Condensed Consolidated Financial Statements and the related notes thereto included elsewhere herein. The following table sets forth, as a percentage of sales, certain operating data appearing in the Company’s Condensed Consolidated Statements of Income and Comprehensive Income:

	Three Months Ended September 30,				Six Months Ended September 30,			
	2012		2011		2012		2011	
Sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of sales	66.7		65.8		67.2		66.6	
Gross profit	33.3		34.2		32.8		33.4	
Operating expenses:								
General and administrative	9.2		9.6		8.9		8.9	
Advertising	12.8		13.6		13.6		13.6	
Depreciation	0.4		0.6		0.4		0.5	
Total operating expenses	22.4		23.8		22.9		23.0	
Income from operations	10.9		10.4		9.9		10.4	
Total other income	0.1		0.2		0.1		0.2	
Income before provision for income taxes	11.0		10.6		10.0		10.6	
Provision for income taxes	4.1		3.9		3.7		3.9	
Net income	6.9	%	6.7	%	6.3	%	6.7	%

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Three Months Ended September 30, 2012 Compared With Three Months Ended September 30, 2011, and Six Months Ended September 30, 2012 Compared With Six Months Ended September 30, 2011

Sales

Sales were $58.1 million for the quarter ended September 30, 2012, slightly down from approximately $58.2 million for the quarter ended September 30, 2011. For the six months ended September 30, 2012, sales decreased by approximately $4.7 million, or 3.6%, to approximately $127.1 million compared to $131.8 million for the six months ended September 30, 2011. For both the three and six months ended September 30, 2012, sales were negatively impacted because of the unavailability of Novartis brands during the period due to the manufacturer's suspended production. Our sales for both periods were also down because of a decline in average order size which was due to additional discounts given, a change in product mix to lower priced items, mainly generics, and increased competition, and for the six months due to customers purchasing smaller quantities, such as a 3-month supply instead of 6 months. The Company acquired approximately 177,000 new customers for the quarter ended September 30, 2012, compared to approximately 184,000 new customers for the same period the prior year. For the six months ended September 30, 2012 the Company acquired approximately 374,000 new customers, compared to 410,000 new customers for the six months ended September 30, 2011. The following chart illustrates sales by various sales classifications:

	Three Months Ended September 30,					
Sales (In thousands)	2012	%	2011	%	$ Variance	% Variance
Reorder Sales	$46,427	79.8 %	$45,477	78.1 %	$950	2.1 %
New Order Sales	$11,718	20.2 %	$12,748	21.9 %	$(1,030)	-8.1 %
Total Net Sales	$58,145	100.0 %	$58,225	100.0 %	$(80)	-0.1 %
Internet Sales	$44,598	76.7 %	$43,343	74.4 %	$1,255	2.9 %
Contact Center Sales	$13,547	23.3 %	$14,882	25.6 %	$(1,335)	-9.0 %
Total Net Sales	$58,145	100.0 %	$58,225	100.0 %	$(80)	-0.1 %

	Six Months Ended September 30,					
Sales (In thousands)	2012	%	2011	%	$ Variance	% Variance
Reorder Sales	$101,488	79.8 %	$102,093	77.5 %	$(605)	-0.6 %
New Order Sales	$25,612	20.2 %	$29,710	22.5 %	$(4,098)	-13.8 %
Total Net Sales	$127,100	100.0 %	$131,803	100.0 %	$(4,703)	-3.6 %
Internet Sales	$97,391	76.6 %	$97,404	73.9 %	$(13)	0.0 %
Contact Center Sales	$29,709	23.4 %	$34,399	26.1 %	$(4,690)	-13.6 %
Total Net Sales	$127,100	100.0 %	$131,803	100.0 %	$(4,703)	-3.6 %

Sales may be adversely affected in Fiscal 2013 due to increased competition and consumers giving more consideration to price and trading down to smaller package quantities and to less expensive brands, including generics. In response to these trends, the Company will focus on advertising efficiency and shifting sales to higher margin items, including generics, combined with expanding our product offerings to pet supplies. No guarantees can be made that the Company's efforts will be successful, or that sales will grow in the future. The majority of our product sales were affected by the seasons, due to the seasonality of mainly heartworm, and flea and tick medications. For the quarters ended June 30, September 30, December 31, and March 31 of Fiscal 2012, the Company's sales were approximately 31%, 24%, 21%, and 24%, respectively.

Cost of sales

Cost of sales increased by approximately $484,000, or 1.3%, to approximately $38.8 million for the quarter ended September 30, 2012, from approximately $38.3 million for the quarter ended September 30, 2011. For the six months ended September 30, 2012, cost of sales decreased by approximately $2.4 million, or 2.7%, to approximately $85.4 million compared to $87.8 million for the same period in the prior year. The increase to cost of sales for the quarter ended September 30, 2012 can be related to increased shipping costs in the period, compared to the same period in the prior year, and the decrease to cost of sales for the six months ended September 30, 2012 is directly related to decreased sales. Cost of sales as a percent of sales was 66.7% and 65.8% for the quarters ended September 30, 2012 and 2011, respectively, and for the six months ended September 30, 2012 and 2011 the cost of sales was 67.2% and 66.6%, respectively. The percentage increases can be mainly attributed to an increase to shipping expenses.

Gross profit

Gross profit decreased by approximately $564,000, or 2.8%, to approximately $19.4 million for the quarter ended September 30, 2012, from approximately $19.9 million for the quarter ended September 30, 2011. For the six months ended September 30, 2012 gross profit decreased by approximately $2.3 million, or 5.4%, to approximately $41.7 million, compared to $44.0 million for the same period in the prior year. Gross profit as a percentage of sales was 33.3% and 34.2% for the three months ended September 30, 2012 and 2011, respectively, and for the six months ended September 30, 2012 and 2011, gross profit was 32.8% and 33.4%, respectively. The percentage decreases can be mainly attributed to an increase to shipping expenses.

General and administrative expenses

General and administrative expenses decreased by approximately $233,000, or 4.2%, to approximately $5.4 million for the quarter ended September 30, 2012, from approximately $5.6 million for the quarter ended September 30, 2011. For the six months ended September 30, 2012, general and administrative expenses decreased by approximately $415,000, or 3.5%, to approximately $11.3 million from approximately $11.7 million for the six months ended September 30, 2011. The decrease in general and administrative expenses for the three months ended September 30, 2012 was primarily due to the following: a $154,000 decrease in bank service fees due to a reduction in credit card fees; a $60,000 reduction in payroll expenses related primarily to a decrease in stock compensation expense; a $59,000 decrease in professional fees, with the majority of the decrease relating to legal and investor relations fees; and a $29,000 decrease in telephone expenses. Offsetting the decrease was a $30,000 increase in property expenses related to our website, and a $39,000 increase in other expenses including licenses and bad debt expense. The decrease in general and administrative expenses for the six months ended September 30, 2012 was primarily due to the following: a $439,000 decrease in bank service fees due to a reduction in credit card fees; a $73,000 decrease in telephone expenses; and a $67,000 decrease in professional fees, with the majority of the decrease relating to legal and investor relations fees. Offsetting the decrease was a $72,000 increase in property expenses related to our website, a $53,000 increase in licenses and fees, and a $39,000 increase in other expenses including office expense, payroll expense, and bad debt expense.

Advertising expenses

Advertising expenses decreased by approximately $480,000, or 6.1%, to approximately $7.4 million for the quarter ended September 30, 2012, from approximately $7.9 million for the quarter ended September 30, 2011. For the six months ended September 30, 2012, advertising expenses decreased by approximately $730,000, or 4.1%, to approximately $17.3 million compared to advertising expenses of approximately $18.0 million for the six months ended September 30, 2011. The decrease in advertising expenses for the three and six months ended September 30, 2012 can be attributed to reduced advertising due to the unavailability of television remnant space inventory. The advertising costs of acquiring a new customer, defined as total advertising costs divided by new customers acquired, decreased to $42 for the quarter ended September 30, 2012, compared to $43 for the quarter ended September 30, 2011. For the six months ended September 30, 2012 the advertising costs of acquiring a new customer increased to $46, compared to $44 for the same period in the prior year. Advertising cost of acquiring a new customer can be impacted by the advertising environment, the effectiveness of our advertising creative, increased advertising spending, and price competition. Historically, the advertising environment fluctuates due to supply and demand. A more favorable advertising environment may positively impact future new order sales, whereas a less favorable advertising environment may negatively impact future new order sales.

As a percentage of sales, advertising expense was 12.8% and 13.6% for the quarters ended September 30, 2012 and 2011, respectively, and for both the six months ended September 30, 2012 and 2011 advertising expense was 13.6%. The decrease in advertising expense as a percentage of total sales for the quarter ended September 30, 2012 can be attributed to a reduction in advertising expenses in the quarter. The Company currently anticipates advertising as a percentage of sales to be approximately 13% for Fiscal 2013. However, the advertising percentage will fluctuate quarter to quarter due to seasonality and advertising availability. For the fiscal year ended March 31, 2012, quarterly advertising expenses as a percentage of sales ranged between 11% and 14%.

Depreciation

Depreciation expenses decreased by approximately $97,000 to approximately $249,000 for the quarter ended September 30, 2012, from approximately $346,000 for the quarter ended September 30, 2011. For the six months ended September 30, 2012 depreciation expenses decreased by approximately $110,000 to $577,000 compared to $687,000 for the same period in the prior year. This decrease to depreciation expense for the quarter and six months ended September 30, 2012 can be attributed to a reduction in new property and equipment additions.

Other income

Other income decreased by approximately $72,000 to approximately $64,000 for the quarter ended September 30, 2012 from approximately $136,000 for the quarter ended September 30, 2011. For the six months ended September 30, 2012 other income decreased by approximately $98,000 to approximately $123,000 compared to approximately $221,000 for the same period in the prior year. The decrease to other income can be primarily attributed to a reduction in other advertising income. Interest income may decrease in the future as the Company utilizes its cash balances on its share repurchase plan, with approximately $10.2 million remaining as of September 30, 2012, on any quarterly dividend payment, or on its operating activities.

Provision for income taxes

For the quarters ended September 30, 2012 and 2011, the Company recorded an income tax provision for approximately $2.4 million and $2.3 million, respectively, and for the six months ended September 30, 2012 and 2011, the Company recorded an income tax provision of approximately $4.7 million and $5.1 million, respectively. The effective tax rate for the quarters ended September 30, 2012 and 2011 was 36.9% and 36.8%, respectively, and for the six months ended September 30, 2012 and 2011 the effective tax rate was 36.9% and 36.8%, respectively. The Company estimates its effective tax rate will be approximately 37.0% for Fiscal 2013.

Liquidity and Capital Resources

The Company's working capital at September 30, 2012 and March 31, 2012 was $77.2 million and $78.2 million, respectively. The $1.0 million decrease in working capital was primarily attributable to share repurchases and dividends paid during the six months, offset by cash flow generated from operations. Net cash provided by operating activities was $15.7 million and $16.2 million for the six months ended September 30, 2012 and 2011, respectively. This change can be attributed to a decrease in the Company's net income for the six months ended September 30, 2012 compared to the same period in the prior year. Net cash used in investing activities was $5.3 million for the six months ended September 30, 2012, compared to cash provided by investing activities of $9.4 million for the six months ended September 30, 2011. This change can be attributed to the redemption of the Company's long term investments balance during the six months ended September 30, 2011, compared to the purchasing of short term investments during the six months ended September 30, 2012. Net cash used in financing activities was $10.2 million for the six months ended September 30, 2012, compared to $28.1 million for the same period in the prior year. This change was primarily due to the Company repurchasing approximately 397,000 shares of its common stock for approximately $3.9 million for the six months ended September 30, 2012, compared to repurchasing approximately 2.0 million shares of its common stock for approximately $22.6 million for the six months ended September 30, 2011. During the six months ended September 30, 2012 the Company paid approximately $6.1 million in dividends, compared to $5.4 million in dividends for the same period in the prior year.

As of September 30, 2012 the Company had approximately $10.2 million remaining under the Company's share repurchase plan. Subsequent to September 30, 2012, on October 26, 2012 our Board of Directors declared a $0.15 per share dividend. The Board established a November 9, 2012 record date and a November 23, 2012 payment date. Depending on future market conditions the Company may utilize its cash and cash equivalents on the remaining balance of its current share repurchase plan, on dividends, or on its operating activities.

As of September 30, 2012 the Company had no outstanding lease commitments except for the lease for its 65,300 square foot facility. We are not currently bound by any long or short term agreements for the purchase or lease of capital expenditures. Any amounts expended for capital expenditures would be the result of an increase in the capacity needed to adequately provide for any increase in our business. To date we have paid for any needed additions to our capital equipment infrastructure from working capital funds and anticipate this being the case in the future. Presently, we have approximately $200,000 forecasted for capital expenditures for the remainder of Fiscal 2013, which will be funded through cash from operations. The Company's primary source of working capital is cash from operations. The Company presently has no need for alternative sources of working capital, and has no commitments or plans to obtain additional capital.

Off-Balance Sheet Arrangements

The Company had no off-balance sheet arrangements as of September 30, 2012.

Cautionary Statement Regarding Forward-Looking Information

Certain information in this Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify these forward-looking statements by the words "believes," "intends," "expects," "may," "will," "should," "plans," "projects," "contemplates," "intends," "budgets," "predicts," "estimates," "anticipates," or similar expressions. These statements are based on our beliefs, as well as assumptions we have used based upon information currently available to us. Because these statements reflect our current views concerning future events, these statements involve risks, uncertainties, and assumptions. Actual future results may differ significantly from the results discussed in the forward-looking statements. A reader, whether investing in our common stock or not, should not place undue reliance on these forward-looking statements, which apply only as of the date of this quarterly report. When used in this quarterly report on Form 10-Q, "PetMed Express," "1-800-PetMeds," "PetMeds," "PetMed," "PetMeds.com,""PetMed.com,""PetMed Express.com," "the Company," "we," "our," and "us" refers to PetMed Express, Inc. and our subsidiaries.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market risk generally represents the risk that losses may occur in the value of financial instruments as a result of movements in interest rates, foreign currency exchange rates, and commodity prices. Our financial instruments include cash and cash equivalents, short term investments, accounts receivable, and accounts payable. The book values of cash equivalents, short term investments, accounts receivable, and accounts payable are considered to be representative of fair value because of the short maturity of these instruments. Interest rates affect our return on excess cash and investments. As of September 30, 2012, we had $47.0 million in cash and cash equivalents and $15.4 million in short term investments. A majority of our cash and cash equivalents and investments generate interest income based on prevailing interest rates.

A significant change in interest rates would impact the amount of interest income generated from our excess cash and investments. It would also impact the market value of our investments. Our investments are subject to market risk, primarily interest rate and credit risk. Our investments are managed by a limited number of outside professional managers within investment guidelines set by our Board of Directors. Such guidelines include security type, credit quality, and maturity, and are intended to limit market risk by restricting our investments to high-quality debt instruments with both short and long term maturities. We do not hold any derivative financial instruments that could expose us to significant market risk. At September 30, 2012, we had no debt obligations.

ITEM 4. CONTROLS AND PROCEDURES.

The Company’s management, including our Chief Executive Officer and Chief Financial Officer, has conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15 promulgated under the Securities Exchange Act of 1934, as amended) as of the quarter ended September 30, 2012, the end of the period covered by this report (the "Evaluation Date"). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective such that the information relating to our Company, including our consolidated subsidiaries, required to be disclosed by the Company in reports that it files or submits under the Exchange Act: (1) is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and (2) is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. There have been no significant changes made in our internal controls over financial reporting or in other factors that could significantly affect, or are reasonably likely to materially affect, our internal controls over financial reporting during the period covered by this report.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

None.

ITEM 1A. RISK FACTORS.

Our operations and financial results are subject to various risks and uncertainties that could adversely affect our business, financial condition, results of operations, and trading price of our common stock. Please refer to our Annual Report on Form 10-K for Fiscal year 2012 for additional information concerning these and other uncertainties that could negatively impact the Company.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

The Company did not make any sales of unregistered securities during the second quarter of fiscal 2013.

Issuer Purchases of Equity Securities

This table provides information with respect to purchases by the Company of shares of common stock during the three months ended September 30, 2012:

Month / Year	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Program
July 2012 (July 1, 2012 to July 31, 2012)	-	$ -	-	$ 14,019,039
August 2012 (August 1, 2012 to August 31, 2012)	394,918	$ 9.74	394,918	$ 10,173,076

September 2012 (September 1, 2012 to September 30, 2012)	2,000	$	9.67	2,000	$	10,153,730

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS

The following exhibits are filed as part of this report.

31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, promulgated under the Securities Exchange Act of 1934, as amended (filed herewith to Exhibit 31.1 of the Registrant’s Report on Form 10-Q for the quarter ended September 30, 2012, Commission File No. 000-28827).

31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, promulgated under the Securities Exchange Act of 1934, as amended (filed herewith to Exhibit 31.2 of the Registrant’s Report on Form 10-Q for the quarter ended September 30, 2012, Commission File No. 000-28827).

32.1 Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith to Exhibit 32.1 of the Registrant’s Report on Form 10-Q for the quarter ended September 30, 2012, Commission File No. 000-28827).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PETMED EXPRESS, INC.
(The "Registrant")

Date: October 31, 2012

By:	/s/ Menderes Akdag Menderes Akdag
	Chief Executive Officer and President (principal executive officer)
By:	/s/ Bruce S. Rosenbloom Bruce S. Rosenbloom
	Chief Financial Officer (principal financial and accounting officer)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

PETMED EXPRESS, INC

FORM 10-Q

FOR THE QUARTER ENDED:

SEPTEMBER 30, 2012

EXHIBITS

EXHIBIT INDEX

Exhibit Number	Description	Number of Pages in Original Document	Incorporated By Reference
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	1	**
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	1	**
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	1	**

** Filed herewith

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$
—

$
2,736,283

Total assets

$
1,662,092

$
1,223,039

$
147,188

$
—

$
3,032,319

Acquisition of real estate

$
181,884

$
156,816

$
—

$
—

$
338,700

Development and property improvement costs

$
16,505

$
147,810

$
—

$
—

$
164,315

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ACADIA REALTY TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	As of or for the Year Ended December 31, 2014				
(in thousands)	Core Portfolio	Funds	Structured Financing	Unallocated	Total
Revenues	$125,022	$54,659	$—	$—	$179,681
Property operating expenses, other operating and real estate taxes	(33,097)	(18,574)	—	—	(51,671)
General and administrative expenses	—	—	—	(27,433)	(27,433)
Depreciation and amortization	(35,875)	(13,770)	—	—	(49,645)
Operating income	56,050	22,315	—	(27,433)	50,932
Equity in (losses) earnings of unconsolidated affiliates	(77)	111,655	—	—	111,578
Gain on disposition of properties	12,577	561	—	—	13,138
Interest income	—	—	12,607	—	12,607
Other	—	—	2,724	—	2,724
Interest and other finance expense	(27,024)	(12,402)	—	—	(39,426)
Income tax provision	—	—	—	(629)	(629)
Income from continuing operations	41,526	122,129	15,331	(28,062)	150,924
Income from discontinued operations	—	1,222	—	—	1,222
Net income	41,526	123,351	15,331	(28,062)	152,146
Net income attributable to noncontrolling interests	(3,222)	(77,860)	—	—	(81,082)
Net income attributable to Acadia	$38,304	$45,491	$15,331	$(28,062)	$71,064
Real estate at cost	$1,366,017	$842,578	$—	$—	$2,208,595
Total assets	$1,613,290	$1,005,145	$102,286	$—	$2,720,721
Acquisition of real estate	$206,203	$50,250	$—	$—	$256,453
Development and property improvement costs	$5,432	$134,686	$—	$—	$140,118

13. Share Incentive and Other Compensation

Share Incentive Plan

At the 2016 annual shareholders' meeting, the shareholders' approved the Second Amended and Restated 2006 Incentive Plan (the "Second Amended 2006 Plan"). This plan replaced all previous share incentive plans and increased the authorization to issue options, Restricted Shares and LTIP Units (collectively "Awards") available to officers and employees by 1,600,000 shares, for a total of 3,700,000 shares available to be issued.

Restricted Shares and LTIP Units

During 2016, the Company issued 319,244 LTIP Units and 11,092 Restricted Share Units to employees of the Company pursuant to the Share Incentive Plan. These awards were measured at their fair value on the grant date, which was established as the market price of the Company's Common Shares as of the close of trading on the day preceding the grant date. The total value of the above Restricted Share Units and LTIP Units as of the grant date was $10.1 million, of which $1.9 million was recognized as compensation expense in 2015, and $8.2 million will be recognized as compensation expense over the vesting period. Additionally, during the quarter ended September 30, 2016, in connection with the retirement of two executives, an additional 29,418 LTIP Units were issued. The value of these LTIP units was $1.1 million and was recognized as compensation expense during 2016. Also in connection with these retirements, the Company recognized $1.8 million as compensation expense relating to the acceleration of LTIP Units granted prior to 2016. Total long-term incentive compensation expense, including the expense related to the above mentioned plans, was $10.9 million, $6.8 million and $6.2 million for the years ended December 31, 2016, 2015 and 2014, respectively and is recorded in General and Administrative on the Consolidated Statements of Income.

In addition, members of the Board of Trustees (the "Board") have been issued units under the Share Incentive Plan. During 2016, the Company issued 13,491 Restricted Shares and 10,822 LTIP Units to Trustees of the Company in connection with Trustee fees. Vesting with respect to 4,674 of the Restricted Shares and 5,532 of the LTIP Units will be on the first anniversary of the date of issuance and 8,817 of the Restricted Shares and 5,290 of the LTIP Units vest over three years with 33% vesting on each of the next three anniversaries of the issuance date. The Restricted Shares do not carry voting rights or other rights of Common Shares until vesting and may not be transferred, assigned or pledged until the recipients have a vested non-forfeitable right to such shares. Dividends are not paid currently on unvested Restricted Shares, but are paid cumulatively from the issuance date through the applicable vesting date of such Restricted Shares. Total trustee fee expense, included the expense related to the above-mentioned plans, was $1.1 million and $0.9 million during 2016 and 2015, respectively.

In 2009, the Company adopted the Long Term Investment Alignment Program (the "Program") pursuant to which the Company may grant awards to employees, entitling them to receive up to 25% of any potential future payments of Promote to the Operating Partnership from Funds III and IV. The Company has awarded units to employees representing 25% of the potential Promote payments from Fund III to the Operating Partnership and 9.3% of the potential Promote payments from Fund IV to the Operating Partnership. Payments to senior executives under the Program require further Board approval at the time any potential payments are due pursuant to these grants. Compensation relating to these awards will be recognized in each reporting period in which Board approval is granted.

As payments to other employees are not subject to further Board approval, compensation relating to these awards will be recorded based on the estimated fair value at each reporting period in accordance with ASC Topic 718, "Compensation– Stock Compensation."

During 2016, compensation expense of $5.0 million was recognized related to the Program in connection with Fund III.

The awards in connection with Fund IV were determined to have no intrinsic value as of December 31, 2016.

A summary of the status of the Company's unvested Restricted Shares and LTIP Units is presented below:

Unvested Restricted Shares and LTIP Units	Common Restricted Shares	Weighted Grant-Date Fair Value	LTIP Units	Weighted Grant-Date Fair Value
Unvested at January 1, 2014	63,737	$ 23.34	884,334	$ 21.62
Granted	28,563	27.18	441,946	26.24
Vested	(34,598)	23.40	(263,556)	20.23
Forfeited	(2,684)	23.54	(800)	24.66
Unvested at December 31, 2014	55,018	25.90	1,061,924	23.92
Granted	22,819	32.78	258,464	34.00
Vested	(24,744)	25.44	(292,544)	22.82
Forfeited	(3,194)	26.25	(7,723)	25.90
Unvested at December 31, 2015	49,899	25.90	1,020,121	23.92
Granted	24,583	33.35	359,484	34.40
Vested	(24,886)	29.17	(522,680)	26.08
Forfeited	(189)	35.37	(48)	35.37
Unvested at December 31, 2016	49,407	27.92	856,877	26.99

The weighted-average fair value for Restricted Shares and LTIP Units granted for the years ended December 31, 2016, 2015 and 2014 were $34.50, $33.90 and $26.30, respectively. As of December 31, 2016, there was $15.5 million of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under share incentive plans. That cost is expected to be recognized over a weighted-average period of 1.9 years. The total fair value of Restricted Shares that vested during the years ended December 31, 2016, 2015 and 2014 was $0.7 million, $0.6 million and $0.8 million, respectively. The total fair value of LTIP Units that vested during the years ended December 31, 2016, 2015 and 2014 was $13.6 million, $6.7 million and $5.3 million, respectively.

ACADIA REALTY TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Stock Options

A summary of option activity under all option arrangements is presented below (dollars in thousands except exercise prices):

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding and exercisable at January 1, 2014	113,086	$ 19.28	3.5	$ 628
Granted	—	—	—	—
Exercised	(57,739)	17.68	—	828
Forfeited or Expired	—	—	—	—
Outstanding and exercisable at December 31, 2014	55,347	$ 20.93	1.1	$ 614
Granted	—	—	—	—
Exercised	(49,098)	20.76	—	608
Forfeited or Expired	(3,000)	22.40	—	—
Outstanding and exercisable at December 31, 2015	3,249	$ 20.93	0.3	35
Granted	—	—	—	—
Exercised	(3,000)	22.40	—	—
Forfeited or Expired	(249)	20.65	—	—
Outstanding and exercisable at December 31, 2016	—	$ —	—	$ —

The total intrinsic value of options exercised during the years ended December 31, 2016, 2015 and 2014 was less than $0.1 million, $0.6 million and $0.8 million, respectively. At December 31, 2016 there were no outstanding options and there was no stock-based compensation expense related to options during the periods presented.

Employee Share Purchase Plan

The Acadia Realty Trust Employee Share Purchase Plan (the "Purchase Plan"), allows eligible employees of the Company to purchase Common Shares through payroll deductions. The Purchase Plan provides for employees to purchase Common Shares on a quarterly basis at a 15% discount to the closing price of the Company’s Common Shares on either the first day or the last day of the quarter, whichever is lower. A participant may not purchase more the $25,000 in Common Shares per year. Compensation expense will be recognized by the Company to the extent of the above discount to the closing price of the Common Shares with respect to the applicable quarter. During the years ended December 31, 2016, 2015 and 2014, a total of 3,491, 3,761 and 4,668 Common Shares, respectively, were purchased by employees under the Purchase Plan. Associated compensation expense was insignificant for each of the years ended December 31, 2016, 2015 and 2014.

Deferred Share Plan

During May of 2006, the Company adopted a Trustee Deferral and Distribution Election ("Trustee Deferral Plan"), under which the participating Trustees have deferred compensation of $0.1 million for each of the three years ended December 31, 2016, 2015 and 2014.

Employee 401(k) Plan

The Company maintains a 401(k) plan for employees under which the Company currently matches 50% of a plan participant's contribution up to 6% of the employee's annual salary. A plan participant may contribute up to a maximum of 15% of their compensation, up to $18,000, for the year ended December 31, 2016. The Company contributed $0.3 million for each of the years ended December 31, 2016, 2015 and 2014.

14. Federal Income Taxes

The Company has elected to qualify as a REIT in accordance with Sections 856 through 860 of the Code, and intends at all times to qualify as a REIT under the Code. To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including a requirement that it currently distribute at least 90% of its annual REIT taxable income to its shareholders. As a REIT, the Company generally will not be subject to corporate Federal income tax, provided that distributions to its shareholders equal at least the amount of its REIT taxable income as defined under the Code. As the Company distributed sufficient taxable income for the years ended December 31, 2016, 2015 and 2014, no U.S. Federal income or excise taxes were incurred. If the Company fails to qualify as a REIT in any taxable year, it will be subject to Federal income taxes at the regular corporate rates (including any applicable alternative minimum tax) and may not be able to qualify as a REIT for the four subsequent taxable years. Even though the Company qualifies for taxation as a REIT, the Company is subject to certain state and local taxes on its income and property and Federal income and excise taxes on any undistributed taxable income. In addition, taxable income from non-REIT activities managed through the Company’s TRS's is subject to Federal, state and local income taxes. For taxable years beginning after 2017, no more than 20% of the value of our total assets may consist of the securities of one or more taxable REIT subsidiaries.

In the normal course of business, the Company or one or more of its subsidiaries is subject to examination by Federal, state and local jurisdictions as well as certain jurisdictions outside the United States, in which it operates, where applicable. The Company expects to recognize interest and penalties related to uncertain tax positions, if any, as income tax expense. For the three years ended December 31, 2016, the Company recognized no material adjustments regarding its tax accounting treatment for uncertain tax provisions. As of December 31, 2016, the tax years that remain subject to examination by the major tax jurisdictions under applicable statutes of limitations are generally the year 2013 and forward.

Reconciliation of Net Income to Taxable Income

Reconciliation of GAAP net income attributable to Acadia to taxable income is as follows:

	Year Ended December 31,		
(dollars in thousands)	2016	2015	2014
Net income attributable to Acadia	$72,776	$65,708	$71,064
Deferred cancellation of indebtedness income	2,050	2,050	2,050
Deferred rental and other income [a]	1,610	82	2,120
Book/tax difference - depreciation and amortization [a]	15,189	9,983	7,337
Straight-line rent and above- and below-market rent adjustments [a]	(7,882)	(8,041)	(4,917)
Book/tax differences - equity-based compensation	10,307	5,833	4,540
Joint venture equity in earnings, net [a]	(2,011)	5,776	(105)
Impairment charges and reserves	769	(714)	3,735
Acquisition costs [a]	5,116	1,190	4,505
Gains	—	(760)	(11,663)
Book/tax differences - miscellaneous	(4,924)	2,573	(6,041)
Taxable income	$93,000	$83,680	$72,625

Distributions declared	$91,053	$84,683	$77,194

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(a) Adjustments from certain subsidiaries and affiliates, which are consolidated for financial reporting but not for tax reporting, are included in the reconciliation item "Joint venture equity in earnings, net."

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ACADIA REALTY TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Characterization of Distributions

The Company has determined that the cash distributed to the shareholders for the periods presented is characterized as follows for Federal income tax purposes:

	Year Ended December 31,					
	2016		2015		2014	
	Per Share	%	Per Share	%	Per Share	%
Ordinary income	$0.77	66 %	$0.83	68 %	$0.85	69 %
Qualified dividend	—	— %	—	— %	—	— %
Capital gain	0.39	34 %	0.39	32 %	0.38	31 %
Total	$1.16	100%	$1.22	100%	$1.23	100%

Taxable REIT Subsidiaries

Income taxes have been provided for using the liability method as required by ASC Topic 740, "Income Taxes." The Company’s TRS income and provision for income taxes associated with the TRS for the periods presented are summarized as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
TRS (loss) income before income taxes	$(1,583)	$1,008	$(36)
Benefit (provision) for income taxes:			
Federal	378	(526)	(377)
State and local	97	(134)	(97)
TRS net (loss) income before noncontrolling interests	(1,108)	348	(510)
Noncontrolling interests	(9)	(208)	(508)
TRS net (loss) income	$(1,117)	$140	$(1,018)

The income tax provision for the Company differs from the amount computed by applying the statutory Federal income tax rate to income before income taxes as follows. Amounts are not adjusted for temporary book/tax differences. (dollars in thousands):

	Year Ended December 31,		
	2016	2015	2014
Federal tax (benefit) provision at statutory tax rate	$(538)	$343	$(12)
TRS state and local taxes, net of Federal benefit	(84)	53	(2)
Tax effect of:			
Permanent differences, net	1,663	396	446
Prior year under-accrual, net	—	938	1
Other	(1,516)	(131)	41
REIT state and local income and franchise taxes	370	188	155
Total (benefit) provision for income taxes	$(105)	$1,787	$629

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15. Earnings Per Common Share

Basic earnings per Common Share is computed by dividing net income attributable to Common Shareholders by the weighted average Common Shares outstanding. At December 31, 2016, the Company has unvested LTIP Units which provide for non-forfeitable rights to dividend equivalent payments. Accordingly, these unvested LTIP Units are considered participating securities and are included in the computation of basic earnings per Common Share pursuant to the two-class method.

Diluted earnings per Common Share reflects the potential dilution of the conversion of obligations and the assumed exercises of securities including the effects of restricted share unit ("Restricted Share Units") and share option awards issued under the Company's Share Incentive Plans (Note 13). The effect of the assumed conversion of 188 Series A Preferred OP Units into 25,067 Common Shares would be anti-dilutive and therefore is not included in the computation of diluted earnings per share for the years ended December 2016, 2015 and 2014. The effect of the assumed conversion of 141,593 Series C Preferred OP Units into 407,845 Common Shares, would be anti-dilutive and therefore is not included in the computation of diluted earnings per share for the year ended December 2016.

The effect of the conversion of Common OP Units is not reflected in the computation of basic and diluted earnings per share, as they are exchangeable for Common Shares on a one-for-one basis. The income allocable to such units is allocated on this same basis and reflected as noncontrolling interests in the accompanying consolidated financial statements. As such, the assumed conversion of these units would have no net impact on the determination of diluted earnings per share.

	Year Ended December 31,		
(shares and dollars in thousands, except per share amounts)	2016	2015	2014
Numerator:			
Income from continuing operations	$72,776	$65,708	$70,865
Less: net income attributable to participating securities	(793)	(927)	(1,152)
Income from continuing operations net of income attributable to participating securities	$71,983	$64,781	$69,713
Denominator:			
Weighted average shares for basic earnings per share	76,231	68,851	59,402
Effect of dilutive securities:			
Employee share options	13	19	24
Denominator for diluted earnings per share	76,244	68,870	59,426
Basic earnings per Common Share from continuing operations attributable to Acadia	$0.94	$0.94	$1.18
Diluted earnings per Common Share from continuing operations attributable to Acadia	$0.94	$0.94	$1.18

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ACADIA REALTY TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Summary of Quarterly Financial Information (unaudited)

The quarterly results of operations of the Company for the years ended December 31, 2016 and 2015 are as follows (in thousands, except per share amounts):

	Three Months Ended [a, b, c, d]			
	March 31, 2016	June 30, 2016	September 30, 2016	December 31, 2016
Revenues	$48,045	$43,918	$ 43,855	$ 54,121
Net income	73,875	26,155	326	34,236
Net (income) loss attributable to noncontrolling interests	(44,950)	(8,237)	5,786	(14,415)
Net income attributable to Acadia	28,925	17,918	6,112	19,821
Earnings per share attributable to Acadia:				
Basic	$0.40	$0.24	$ 0.08	$ 0.24
Diluted	0.40	0.24	0.08	0.24
Weighted average number of shares:				
Basic	70,756	72,896	78,449	82,728
Diluted	71,215	72,896	78,624	82,728
Cash dividends declared per Common Share	$0.25	$0.25	$ 0.25	$ 0.41

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(a) The three months ended March 31, 2016 includes Fund III's $65.4 million gain on sale of its 65% consolidated interest in Cortlandt Town Center of which $49.4 million was attributable to noncontrolling interests (Note 2).

(b) The three months ended June 30, 2016 includes a $16.6 million gain on sale of Fund III's consolidated Heritage Shops property of which $12.5 million was attributable to noncontrolling interests (Note 2).

(c) The three months ended June 30, 2016, September 30, 2016 and December 31, 2016 reflect the impact of the de-consolidation of the Company's investment in the Brandywine portfolio, which was effective May 1, 2016 (Note 4).

(d) The three months ended December 31, 2016 reflect the impact of an out-of-period adjustment resulting in a net decrease to net income of $4.2 million, of which $1.6 million was attributable to noncontrolling interests (Note 1).

	Three Months Ended [a, b, c]			
	March 31, 2015	June 30, 2015	September 30, 2015	December 31, 2015
Revenues	$49,073	$49,176	$51,124	$51,286
Net income	38,537	85,458	18,104	7,871
Net (income) loss attributable to noncontrolling interests	(21,990)	(58,963)	(4,328)	1,019
Net income attributable to Acadia	16,547	26,495	13,776	8,890

Earnings per share attributable to Acadia:				
Basic	$0.24	$0.38	$0.20	$0.13
Diluted	0.24	0.38	0.20	0.13
Weighted average number of shares:				
Basic	68,295	68,825	68,943	69,328
Diluted	68,360	68,870	68,957	69,330
Cash dividends declared per Common Share	$0.24	$0.24	$0.24	$0.50

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(a) The three months ended March 31, 2015 includes a gain on the disposition of Fund III's consolidated Lincoln Park Centre property of $27.1 million of which $21.7 million was attributable to noncontrolling interests (Note 2).

(b) The three months ended June 30, 2015 includes: Acadia's $17.1 million share of the gain on disposition of Fund III's unconsolidated White City Shopping Center (Note 4); a $12.0 million gain on disposition of Fund II's consolidated Liberty Avenue property and a $49.9 million gain on disposition of Fund II's consolidated City Point property's air rights, of which a total of $15.8 million was attributable to noncontrolling interests (Note 2); and a $5.0 million asset impairment charge within the Brandywine portfolio inclusive of $3.9 million attributable to noncontrolling interests (Note 8).

(c) The three months ended September 30, 2015 includes Acadia's $6.9 million share of the gain on disposition of Fund III's unconsolidated Parkway Crossing property of which $5.6 million was attributable to noncontrolling interests.

17. Subsequent Events

Dispositions

In February 2017, Fund III completed the disposition of Arundel Plaza, located in Glen Burnie, MD, for a sales price of $28.8 million.

In January 2017, Fund IV completed the disposition of 2819 Kennedy Boulevard, located in North Bergen, NJ, for a sales price of $19.0 million.

In February 2017, there was an auction pursuant to an Order of the United States Bankruptcy Court for the Southern District of New York for the property which is collateral for the Company's non-performing note (Note 3). The winning bid was in excess of the Company's carrying value and accrued interest. The sale of this property is expected to be approved by Order of the Bankruptcy Court confirming the Chapter 11 Plan of Reorganization of the note issuer and close during the first half of 2017. In connection with this, the Company anticipates recovering its full carrying value of principal and accrued interest upon settlement of this transaction.

Financings

In February 2017, the Company completed the financing of Fund IV's Wake Forest property (Note 2) for $24.0 million. The new loan bears interest at LIBOR plus 160 basis points and matures February 14, 2020.

ACADIA REALTY TRUST
SCHEDULE II-VALUATION AND QUALIFYING ACCOUNTS

	Balance at Beginning of Year	Charged to Expenses	Adjustments to Valuation Accounts	Deductions	Balance at End of Year
Year ended December 31, 2016:					
Allowance for deferred tax asset	$ —	$ —	$ 859	$ —	$ 859
Allowance for uncollectible accounts	$ 7,451	$ —	$ —	$ (1,731)	$ 5,720
Allowance for notes receivable	$ —	$ —	$ —	$ —	$ —
Year ended December 31, 2015:					
Allowance for deferred tax asset	$ —	$ —	$ —	$ —	$ —
Allowance for uncollectible accounts	$ 5,952	$ 1,499	$ —	$ —	$ 7,451
Allowance for notes receivable	$ —	$ —	$ —	$ —	$ —
Year ended December 31, 2014:					
Allowance for deferred tax asset	$ —	$ —	$ —	$ —	$ —
Allowance for uncollectible accounts	$ 6,242	$ —	$ —	$ (290)	$ 5,952
Allowance for notes receivable	$ 3,681	$ —	$ —	$ (3,681)	$ —

ACADIA REALTY TRUST
SCHEDULE III-REAL ESTATE AND ACCUMULATED DEPRECIATION
December 31, 2016

		Initial Cost to Company			Amount at Which Carried at December 31, 2016						
Description	Encumbrances	Land	Buildings & Improvements	Increase (Decrease) in Net Investments	Land	Buildings & Improvements	Total	Accumulated Depreciation	Date of Acquisition (a) Construction (c)		Life on which Depreciation in Latest Statement of Income is Compared
Core Portfolio:											
Crescent Plaza Brockton, MA	$ —	$ 1,147	$ 7,425	$ 3,027	$ 1,147	$ 10,452	11,599	$ 7,395	1993	(a)	40 years
New Loudon Center Latham, NY	—	505	4,161	13,353	505	17,514	18,019	13,968	1993	(a)	40 years
Mark Plaza Edwardsville, PA	—	—	3,396	—	—	3,396	3,396	2,887	1993	(c)	40 years
Plaza 422 Lebanon, PA	—	190	3,004	2,765	190	5,769	5,959	5,155	1993	(c)	40 years
Route 6 Mall Honesdale, PA	—	1,664	—	12,437	1,664	12,437	14,101	8,559	1994	(c)	40 years
Abington Towne Center Abington, PA	—	799	3,197	2,400	799	5,597	6,396	3,754	1998	(a)	40 years
Bloomfield Town Square Bloomfield Hills, MI	—	3,207	13,774	22,463	3,207	36,237	39,444	19,922	1998	(a)	40 years
Elmwood Park Shopping Center Elmwood Park, NJ	—	3,248	12,992	15,860	3,798	28,302	32,100	18,112	1998	(a)	40 years
Merrillville Plaza Hobart, IN	24,779	4,288	17,152	5,647	4,288	22,799	27,087	18,276	1998	(a)	40 years
Marketplace of Absecon Absecon, NJ	—	2,573	10,294	4,900	2,577	15,190	17,767	7,612	1998	(a)	40 years
239 Greenwich Avenue Greenwich, CT	27,000	1,817	15,846	776	1,817	16,622	18,439	7,389	1998	(a)	40 years

Hobson West Plaza Naperville, IL	—	1,793	7,172	1,970	1,793	9,142	10,9,3855	1998	(a)	40 years
Village Commons Shopping Center Smithtown, NY	—	3,229	12,917	4,225	3,229	17,142	20,8,3752	1998	(a)	40 years
Town Line Plaza Rocky Hill, CT	—	878	3,510	7,736	907	11,217	12,8,2914	1998	(a)	40 years
Branch Shopping Center Smithtown, NY	—	3,156	12,545	15,883	3,401	28,183	31,5,8749	1998	(a)	40 years
Methuen Shopping Center Methuen, MA	—	956	3,826	993	961	4,814	5,72,5369	1998	(a)	40 years
Gateway Shopping Center South Burlington, VT	—	1,273	5,091	12,258	1,273	17,349	18,6,2902	1999	(a)	40 years
Mad River Station Dayton, OH	—	2,350	9,404	1,579	2,350	10,983	13,5,3256	1999	(a)	40 years
Pacesetter Park Shopping Center Ramapo, NY	—	1,475	5,899	3,350	1,475	9,249	10,4,7603	1999	(a)	40 years
Brandywine Holdings Wilmington, DE	26,250	5,063	15,252	2,495	5,201	17,609	22,8,1092	2003	(a)	40 years
Bartow Avenue Bronx, NY	—	1,691	5,803	1,111	1,691	6,914	8,60,5732	2005	(c)	40 years
Amboy Road Staten Island, NY	—	—	11,909	2,482	—	14,391	14,5,9812	2005	(a)	40 years
Clark Diversey Chicago, IL	—	10,061	2,773	972	10,061	3,745	13,8806	2006	(a)	40 years
Chestnut Hill Philadelphia, PA	—	8,289	5,691	4,509	8,289	10,200	18,4,8975	2006	(a)	40 years
	—	11,108	8,038	4,701	11,855	11,992	23,8,4756	2006	(a)	40 years

2914 Third Avenue Bronx, NY											
West Shore Expressway Staten Island, NY	—	3,380	13,499	—	3,380	13,499	16,879	[illegible]	2007	(a)	40 years
West 54th Street Manhattan, NY	—	16,699	18,704	992	16,699	19,696	36,395	[illegible]	2007	(a)	40 years
5-7 East 17th Street Manhattan, NY	—	3,048	7,281	5,147	3,048	12,428	15,476	[illegible]	2008	(a)	40 years

Description	Encumbrances	Initial Cost to Company: Land	Initial Cost to Company: Buildings & Improvements	Increase (Decrease) in Net Investments	Amount at Which Carried at December 31, 2016: Land	Amount at Which Carried at December 31, 2016: Buildings & Improvements	Total	Accumulated Depreciation	Date of Acquisition (a) Construction (c)		Life on which Depreciation in Latest Statement of Income is Compared
651-671 W Diversey Chicago, IL	—	8,576	17,256	8	8,576	17,264	25,840	2,409	2011	(a)	40 years
15 Mercer Street New York, NY	—	1,887	2,483	—	1,887	2,483	4,370	341	2011	(a)	40 years
4401 White Plains Bronx, NY	5,884	1,581	5,054	—	1,581	5,054	6,635	674	2011	(a)	40 years
Chicago Street Retail Portfolio Chicago, IL	—	18,521	55,627	1,923	18,560	57,511	76,071	6,761	2012	(a)	40 years
1520 Milwaukee Avenue Chicago, IL	—	2,110	1,306	—	2,110	1,306	3,416	161	2012	(a)	40 years
330-340 River Street Cambridge, MA	11,884	8,404	14,235	—	8,404	14,235	22,639	1,812	2012	(a)	40 years
Rhode Island Place Shopping Center Washington, D.C.	—	7,458	15,968	917	7,458	16,885	24,343	2,142	2012	(a)	40 years
930 Rush Street Chicago, IL	—	4,933	14,587	9	4,933	14,596	19,529	1,732	2012	(a)	40 years
28 Jericho Turnpike Westbury, NY	14,869	6,220	24,416	—	6,220	24,416	30,636	2,935	2012	(a)	40 years
181 Main Street Westport, CT	—	1,908	12,158	41	1,908	12,199	14,107	1,278	2012	(a)	40 years
83 Spring Street Manhattan, NY	—	1,754	9,200	—	1,754	9,200	10,954	1,035	2012	(a)	40 years
60 Orange Street Bloomfield, NJ	7,769	3,609	10,790	—	3,609	10,790	14,399	1,264	2012	(a)	40 years
179-53 & 1801-03 Connecticut Avenue Washington, D.C.	—	11,690	10,135	726	11,689	10,862	22,551	1,199	2012	(a)	40 years
639 West Diversey Chicago, IL	—	4,429	6,102	804	4,429	6,906	11,335	775	2012	(a)	40 years
664 North Michigan Chicago, IL	41,846	15,240	65,331	—	15,240	65,331	80,571	6,345	2013	(a)	40 years
8-12 E. Walton Chicago, IL	—	5,398	15,601	29	5,398	15,630	21,028	1,414	2013	(a)	40 years
3200-3204 M Street Washington, DC	—	6,899	4,249	168	6,899	4,417	11,316	461	2013	(a)	40 years

868 Broadway Manhattan, NY	—	3,519	9,247	5	3,519	9,252	12,771	711	2013	(a)	40 years
313-315 Bowery Manhattan, NY	—	—	5,516	—	—	5,516	5,516	670	2013	(a)	40 years
120 West Broadway Manhattan, NY	—	—	32,819	919	—	33,738	33,738	1,593	2013	(a)	40 years
11 E. Walton Chicago, IL	—	16,744	28,346	192	16,744	28,538	45,282	2,198	2014	(a)	40 years
61 Main Street Westport, CT	—	4,578	2,645	20	4,578	2,665	7,243	343	2014	(a)	40 years
865 W. North Avenue Chicago, IL	—	1,893	11,594	23	1,893	11,617	13,510	103	2014	(a)	40 years
152-154 Spring Street Manhattan, NY	—	8,544	27,001	—	8,544	27,001	35,545	1,834	2014	(a)	40 years
2520 Flatbush Avenue Brooklyn, NY	—	6,613	10,419	193	6,613	10,612	17,225	254	2014	(a)	40 years
252-256 Greenwich Avenue Greenwich, CT	—	10,175	12,641	119	10,175	12,760	22,935	358	2014	(a)	40 years
Bedford Green Bedford Hills, NY	28,697	12,425	32,730	1,801	12,425	34,531	46,956	3,264	2014	(a)	40 years
131-135 Prince Street Manhattan, NY	—	—	57,536	103	—	57,639	57,639	3,844	2014	(a)	40 years
Shops at Grand Ave Queens, NY	—	20,264	33,131	279	20,264	33,410	53,674	1,898	2014	(a)	40 years
201 Needham Street Newton, MA	—	4,550	4,459	105	4,550	4,564	9,114	403	2014	(a)	40 years
City Center San Francisco, CA	—	36,063	109,098	658	36,063	109,756	145,819	4,909	2015	(a)	40 years
163 Highland Avenue Needham, MA	9,359	12,679	11,213	—	12,679	11,213	23,892	924	2015	(a)	40 years
Roosevelt Galleria Chicago, IL	—	4,838	14,574	26	4,838	14,600	19,438	389	2015	(a)	40 years
Route 202 Shopping Center, Wilmington, DE	—	—	6,346	—	—	6,346	6,346	302	2015	(a)	40 years
991 Madison Avenue New York, NY	—		76,965	—	—	76,965	76,965	—	2016	(a)	40 years

		Initial Cost to Company			Amount at Which Carried at December 31, 2016						
Description	Encumbrances	Land	Buildings & Improvements	Increase (Decrease) in Net Investments	Land	Buildings & Improvements	Total	Accumulated Depreciation	Date of Acquisition (a) Construction (c)		Life on which Depreciation in Latest Statement of Income is Compared
165 Newbury Street Boston, MA	—	1,918	3,980	—	1,918	3,980	5,898	86	2016	(a)	40 years
Concord & Milwaukee Chicago, IL	2,874	2,739	2,746	—	2,739	2,746	5,485	30	2016	(a)	40 years
State & Washington Chicago, IL	25,485	3,907	70,943	—	3,907	70,943	74,850	591	2016	(a)	40 years
151 N. State Street Chicago, IL	14,464	1,941	25,529	—	1,941	25,529	27,470	206	2016	(a)	40 years
North & Kingsbury Chicago, IL	13,292	18,731	16,292	—	18,731	16,292	35,023	241	2016	(a)	40 years
Sullivan Center Chicago, IL	—	13,433	137,327	10	13,443	137,327	150,770	1,745	2016	(a)	40 years
California & Armitage Chicago, IL	2,675	6,770	2,292	—	6,770	2,292	9,062	21	2016	(a)	40 years
555 9th Street San Francisco, CA	60,000	75,591	73,268	—	75,591	73,268	148,859	358	2016	(a)	40 years
Undeveloped Land	—	100	—	—	100	—	100	—			
Fund II:											
161st Street Bronx, NY	46,500	16,679	28,410	28,272	16,679	56,682	73,361	13,067	2005	(a)	40 years
City Point Brooklyn, NY	326,042	—	—	207,561	—	207,561	207,561	1,848	2010	(c)	40 years
Fund III:											
654 Broadway Manhattan, NY	8,615	9,040	3,654	2,869	9,040	6,523	15,563	636	2011	(a)	40 years
New Hyde Park Shopping Center New Hyde Park, NY	10,760	3,016	7,733	4,151	3,016	11,884	14,900	2,225	2011	(a)	40 years
640 Broadway Manhattan, NY	48,470	12,503	19,960	10,953	12,503	30,913	43,416	3,799	2012	(a)	40 years
3780-3858 Nostrand Avenue Brooklyn, NY	11,137	6,229	11,216	5,612	6,229	16,828	23,057	1,463	2013	(a)	40 years

Fund IV:											
Paramus Plaza Paramus, NJ	14,099	11,052	7,037	8,280	11,052	15,317	26,369	962	2013	(a)	40 years
1151 Third Ave Manhattan, NY	12,481	8,306	9,685	1,412	8,306	11,097	19,403	990	2013	(a)	40 years
Lake Montclair Center Dumfries, VA	14,509	7,077	12,028	439	7,077	12,467	19,544	1,103	2013	(a)	40 years
938 W. North Avenue Chicago, IL	12,500	2,314	17,067	176	2,314	17,243	19,557	1,310	2013	(a)	40 years
17 E. 71st Street Manhattan, NY	19,000	7,391	20,176	263	7,391	20,439	27,830	1,149	2014	(a)	40 years
1035 Third Ave Manhattan, NY	41,826	14,099	39,928	671	14,099	40,599	54,698	1,858	2015	(a)	40 years
801 Madison Avenue Manhattan, NY	—	4,178	28,470	—	4,178	28,470	32,648	890	2015	(a)	40 years
2208-2216 Fillmore Street San Francisco, CA	5,606	3,027	6,376	—	3,027	6,376	9,403	186	2015	(a)	40 years
146 Geary Street San Francisco, CA	27,700	9,500	28,500	7	9,500	28,507	38,007	831	2015	(a)	40 years
2207 Fillmore Street San Francisco, CA	1,120	1,498	1,735	108	1,498	1,843	3,341	48	2015	(a)	40 years
1861 Union Street San Francisco, CA	2,315	2,188	1,293	—	2,188	1,293	3,481	35	2015	(a)	40 years
Restaurants at Fort Point Boston, MA	6,500	1,041	10,905	—	1,041	10,905	11,946	273	2016	(a)	40 years
Wakeforest Crossing Wake Forest, NC	—	7,570	24,829	1	7,570	24,830	32,400	97	2016	(a)	40 years
Airport Mall Bangor, ME	—	2,294	7,067	11	2,294	7,078	9,372	40	2016	(a)	40 years
Colonie Plaza Albany, NY	—	2,852	9,619	—	2,852	9,619	12,471	78	2016	(a)	40 years
Dauphin Plaza Harrisburg, PA	—	5,290	9,464	4	5,290	9,468	14,758	50	2016	(a)	40 years
JFK Plaza Waterville, ME	—	751	5,991	2	751	5,993	6,744	32	2016	(a)	40 years
Mayfair Shopping Center Philadelphia, PA	—	6,178	9,266	2	6,178	9,268	15,446	12	2016	(a)	40 years
Shaw's Plaza Waterville, ME	—	828	11,814	1	828	11,815	12,643	53	2016	(a)	40 years

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		Initial Cost to Company			Amount at Which Carried at December 31, 2016					
Description	Encumbrances	Land	Buildings & Improvements	Increase (Decrease) in Net Investments	Land	Buildings & Improvements	Total	Accumulated Depreciation	Date of Acquisition (a) Construction (c)	
Wells Plaza Wells, ME	—	1,892	2,585	—	1,892	2,585	4,477	18	2016	(a)
717 N. Michigan Chicago, IL	63,900	72,174	34,606	—	72,174	34,606	106,780	72	2016	(a)
Real Estate Under Development	55,327	105,442	61,172	376,872	58,403	485,083	543,486	—		(a)
Debt of Assets Held For Sale	25,500									
Unamortized Loan Costs	(16,642)	—	—	—	—	—	—	—		
Unamortized Premium	1,336	—	—	—	—	—	—	—		
Total	$1,055,728	$796,928	$1,774,296	$810,776	$751,655	$2,630,345	$3,382,000	$287,066		

Notes:

1. Depreciation on buildings and improvements reflected in the consolidated statements of income is calculated over the estimated useful life of the assets as follows: Buildings at 30 to 40 years and improvements at the shorter of lease term or useful life.
2. The aggregate gross cost of property included above for Federal income tax purposes was $2,550.5 million as of December 31, 2016.

The following table reconciles the activity for real estate properties from January 1, 2014 to December 31, 2016 (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Balance at beginning of year	$2,736,283	$2,208,595	$1,819,053
Other improvements	152,129	162,760	162,827
Property acquisitions	761,400	418,396	299,793
Property dispositions or held for sale assets	(134,332)	(66,359)	(73,078)
Prior year purchase price allocation adjustments	(9,844)	—	—
Deconsolidation of Previously Consolidated Investments	(123,636)	—	—
Consolidation of Previously Unconsolidated Investments	—	12,891	—
Balance at end of year	$3,382,000	$2,736,283	$2,208,595

The following table reconciles accumulated depreciation from January 1, 2014 to December 31, 2016 (in thousands):

Year Ended December 31,

	2016	2015	2014
Balance at beginning of year	$298,703	$256,015	$229,538
Depreciation related to real estate	49,269	49,775	26,477
Property Dispositions	(27,829)	(7,087)	—
Deconsolidation of Previously Consolidated Investments	(33,077)	—	—
Consolidation of previously unconsolidated investments	—	—	—
Balance at end of year	$287,066	$298,703	$256,015

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ACADIA REALTY TRUST
SCHEDULE IV-MORTGAGE LOANS ON REAL ESTATE
(in thousands)
December 31, 2016

Description	Effective Interest Rate	Final Maturity Date	Face Amount of Notes Receivable	Net Carrying Amount of Notes Receivable as of December 31, 2016
First Mortgage Loan	6.0%	4/28/2017	$ 9,000	$ 9,000
First Mortgage Loan	6.0%	5/1/2017	15,000	15,000
Mezzanine Loan	18.0%	7/1/2017	3,007	4,506
First Mortgage Loan	LIBOR + 7.1%	6/25/2018	26,000	26,000
First Mortgage Loan	8.1%	4/30/2019	153,400	153,400
Preferred Equity	8.7%	9/9/2019	10,000	10,000
Zero Coupon Loan	2.5%	5/31/2020	29,793	31,007
Preferred Equity	15.3%	2/3/2021	14,000	15,250
First Mortgage Loan	9.0%	Demand	12,000	12,000
Total			$ 272,200	$ 276,163

The Company monitors the credit quality of its notes receivable on an ongoing basis and considers indicators of credit quality such as loan payment activity, the estimated fair value of the underlying collateral, the seniority of the Company's loan in relation to other debt secured by the collateral, the personal guarantees of the borrower and the prospects of the borrower. As of December 31, 2016, the Company held one non-performing note in the amount of $12.0 million.

The following table reconciles the activity for loans on real estate from January 1, 2014 to December 31, 2016 (in thousands):

	Reconciliation of Loans on Real Estate Year Ended December 31,		
	2016	2015	2014
Balance at beginning of year	$147,188	$102,286	$126,656
Additions	171,794	48,500	31,169
Disposition of air rights through issuance of notes	—	29,539	—
Amortization and accretion	—	—	556
Repayments	(42,819)	(15,984)	(18,095)
Conversion to real estate through receipt of deed or through foreclosure	—	(13,386)	(38,000)
Other	—	(3,767)	—
Balance at end of year	$276,163	$147,188	$102,286