

**THE PETCO FOUNDATION**  
**FINANCIAL STATEMENTS**  
**WITH INDEPENDENT AUDITORS' REPORT**

For the Years Ended April 29, 2017 and April 30, 2016

**THE PETCO FOUNDATION**  
**TABLE OF CONTENTS**  
April 29, 2017 and April 30, 2016

	<u>Page</u>
Independent Auditors' Report .....	1
<u>Financial Statements:</u>	
Statements of Financial Position .....	3
Statements of Activities and Changes in Net Assets .....	4
Statements of Cash Flows.....	5
Notes to Financial Statements .....	6

## INDEPENDENT AUDITORS' REPORT

The Board of Directors  
The Petco Foundation  
San Antonio, Texas

### *Report on the Financial Statements*

We have audited the accompanying financial statements of The Petco Foundation (the Foundation), which comprise the statements of financial position as of April 29, 2017 and April 30, 2016, and the related statements of activities and changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Foundation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion the financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of April 29, 2017 and April 30, 2016, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

*RBTK, LLP*

September 13, 2017

**THE PETCO FOUNDATION**  
**STATEMENTS OF FINANCIAL POSITION**

**ASSETS**

	<u>April 29, 2017</u>	<u>April 30, 2016</u>
Cash and cash equivalents	\$ 5,075,744	9,076,728
Receivable from Petco Animal Supplies Stores, Inc. (Note 4)	2,350,729	2,111,330
Other receivables	154,458	2,437
Prepaid expenses	479,609	145,305
Long-term investments, at fair value (Note 3)	<u>4,879,148</u>	<u>4,154,849</u>
 Total assets	 <u>\$ 12,939,688</u>	 <u>15,490,649</u>

**LIABILITIES AND NET ASSETS**

Liabilities:		
Accounts payable and accrued expenses	\$ 183,677	375,608
Deferred revenue	315,687	-
Due to Petco Animal Supplies Stores, Inc. (Note 4)	<u>291,594</u>	<u>484,442</u>
 Total liabilities	 <u>790,958</u>	 <u>860,050</u>
 Net assets:		
Unrestricted	<u>12,148,730</u>	<u>14,630,599</u>
 Total net assets	 <u>12,148,730</u>	 <u>14,630,599</u>
 Total liabilities and net assets	 <u>\$ 12,939,688</u>	 <u>15,490,649</u>

See Accompanying Notes to Financial Statements

**THE PETCO FOUNDATION**  
**STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS**

	For the Years Ended	
	April 29, 2017	April 30, 2016
Changes in unrestricted net assets:		
Support and revenue:		
Contributions from individuals and corporations	\$ 29,023,440	28,108,755
Petco Animal Supplies Stores, Inc. in-kind contributions (Notes 4 and 5)	-	1,079,817
Total contributions	29,023,440	29,188,572
Special events:		
Revenue	1,394,800	2,133,589
Expense	(420,005)	(805,499)
Net special events revenue	974,795	1,328,090
Merchandise:		
Revenue	1,523,986	1,779,665
Expense	(173,736)	(179,535)
Net merchandise revenue	1,350,250	1,600,130
Interest income	26,213	31,497
Net long-term investment return (loss) (Note 3)	676,164	(133,625)
Total unrestricted support and revenue	32,050,862	32,014,664
Expenditures:		
Program:		
Grants investments	30,417,219	32,098,268
Program service expenses	1,401,579	951,378
Total program	31,818,798	33,049,646
Fundraising	1,598,177	1,614,795
Management and general	1,115,756	1,302,161
Total expenditures	34,532,731	35,966,602
Change in unrestricted net assets	(2,481,869)	(3,951,938)
Net assets, beginning of year	14,630,599	18,582,537
Net assets, end of year	\$ 12,148,730	14,630,599

See Accompanying Notes to Financial Statements

**THE PETCO FOUNDATION**  
**STATEMENTS OF CASH FLOWS**

	For the Years Ended	
	April 29, 2017	April 30, 2016
Cash flows from operating activities:		
Change in net assets	\$ (2,481,869)	(3,951,938)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Net long-term investment (return) loss	(676,164)	133,625
Donated investments	(48,135)	-
Increase in receivable from Petco Animal Supplies Stores, Inc.	(239,399)	(293,710)
Increase in other receivables	(152,021)	116,654
(Increase) decrease in prepaid expense	(334,304)	70,375
Increase (decrease) in accounts payable and accrued expenses	(191,931)	220,505
Increase (decrease) in deferred revenue	315,687	(166,000)
(Decrease) increase in due to Petco Animal Supplies Stores, Inc.	(192,848)	201,091
Net cash used in operating activities	(4,000,984)	(3,669,398)
Net decrease in cash and cash equivalents	(4,000,984)	(3,669,398)
Cash and cash equivalents, beginning of year	9,076,728	12,746,126
Cash and cash equivalents, end of year	\$ 5,075,744	9,076,728
Supplemental disclosures:		
Interest paid	\$ -	-
Income taxes paid	\$ -	-

See Accompanying Notes to Financial Statements

**THE PETCO FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
April 29, 2017 and April 30, 2016

**1. Organization**

The Petco Foundation (the Foundation), a California non-profit public benefit corporation incorporated on February 16, 1999, is organized to promote, enhance and finance charitable, educational, literary, scientific and prevention of cruelty to animals activities through grants and contributions to organizations that conduct or sponsor charitable or educational programs related to domesticated animals. The Foundation may also conduct and/or sponsor charitable or educational programs, events or activities which further the purpose of the Foundation.

The Foundation accomplishes its chartered purpose primarily through grant investments in non-profit organizations that make the most impact, determined through a decision model designed to evaluate and assess organizations alongside their peers. The Foundation seeks to empower those organizations that are the most productive and effective in accomplishing their mission and support animal welfare organizations seeking to end the euthanasia of shelter animals, those organizations supporting service, therapy and working animals, and organizations and institutions helping to find a cure or support treatment of pet cancer.

The Foundation is exempt from income tax under Section 501(c)(3) of the United States Internal Revenue Code (the Code), and similar provisions of the California Revenue and Taxation Code and the Texas Tax Code, and contributions to it are deductible within the limitations prescribed by the Code. The Foundation has been classified as a publicly supported organization, which is not a private foundation under Section 509(a) of the Code.

The Foundation's fiscal year ends on the Saturday closest to April 30, resulting in years of either 52 or 53 weeks. All references to a fiscal year refer to the fiscal year ending on the Saturday closest to April 30 of the following year. The fiscal years ended April 29, 2017 (fiscal year 2016) and April 30, 2016 (fiscal year 2015) each consisted of 52 weeks.

**2. Summary of Significant Accounting Policies**

The financial statements of the Foundation have been prepared on the accrual basis of accounting whereby revenues are recognized when earned and expenses are recognized when incurred. The significant accounting policies followed are discussed below.

**THE PETCO FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS, CONTINUED**  
April 29, 2017 and April 30, 2016

**2. Summary of Significant Accounting Policies, Continued**

*Cash and Cash Equivalents*

Cash equivalents represent all liquid investments with original maturities of three months or less and include money market funds.

*Other Receivables*

Other receivables consist of event sponsorships and contributions received via mobile and online fundraising solutions and are stated at the amount management expects to collect. Other receivables are reviewed for collectability and reserves for uncollectible accounts are recorded based on established policies. Management believes that all other receivables are fully collectible within one year and no allowance for doubtful accounts was necessary at April 29, 2017 or April 30, 2016.

*Investments*

The Foundation accounts for investments pursuant to U.S. generally accepted accounting principles under which investments with readily determinable fair values are reported at their fair values in the statement of financial position. Donated investments are recorded at their fair value on the date of receipt. Net investment return or loss (including realized and unrealized gains and losses on investments, interest, dividends, and fees) is included in the statement of activities as a change in net assets.

*Fair Value Measurements*

U.S. generally accepted accounting principles provide guidance on how fair value should be determined when financial statement elements are required to be measured at fair value. Valuation techniques are ranked in three levels depending on the degree of objectivity of the inputs used with each level:

Level 1 inputs – quoted prices in active markets for identical assets

Level 2 inputs – quoted prices in active or inactive markets for the same or similar assets

Level 3 inputs – estimates using best information available when there is little or no market

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. The Foundation is required to measure certain financial instruments at fair value in accordance with U.S. generally accepted accounting principles. The technique used to measure the fair value of investments is described in Note 3.

**THE PETCO FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS, CONTINUED**  
April 29, 2017 and April 30, 2016

**2. Summary of Significant Accounting Policies, Continued**

Contributions

U.S. generally accepted accounting principles require that the Foundation report information about its financial position and activities in three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. Unrestricted contributions are recognized as increases in unrestricted net assets when received. Contributions restricted by donors may be reported as increases in temporarily or permanently restricted net assets, depending on the nature of the donor-imposed restriction. When restrictions are satisfied, either by the passage of time or by accomplishing the purpose, the temporarily restricted contributions are reclassified to unrestricted net assets and reported in the activity statement as net assets released from restrictions. When restrictions are satisfied in the same period as the receipt of contributions, the Foundation reports both the revenue and the related expense in the unrestricted net assets class.

Donated Goods, Services and Facilities

Those donated goods that meet the requirements for recognition under U.S. generally accepted accounting principles are recorded as both revenue and expense in the accompanying statement of activities, at amounts determined by management to be reasonable for obtaining such goods.

Advertising

The Company expenses all advertising costs as incurred. The primary purpose of the Foundation's advertising is to promote and encourage the adoption of pets and to highlight the Foundation's grant investments and the work being done by animal welfare organizations throughout the country to save lives. Advertising expense was \$514,632 and \$143,198, for the years ended April 29, 2017 and April 30, 2016, respectively.

Deferred Revenue

Revenues received in advance of a special event are deferred. The revenues are recognized when the event occurs.

Receivable from Petco Animal Supplies Stores, Inc.

Petco Animal Supplies Stores, Inc. (Petco) retail locations serve as collection points for donations received from the general public for various Foundation fundraising activities. These donations are then periodically transferred to the Foundation. Management believes that all contributions receivable are fully collectible within one year; therefore, no allowance for doubtful accounts was recorded as of April 29, 2017 or April 30, 2016.

**THE PETCO FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS, CONTINUED**  
April 29, 2017 and April 30, 2016

**2. Summary of Significant Accounting Policies, Continued**

*Income Taxes*

The Foundation is exempt from federal and state income tax liability, and therefore, no provision is made for current or deferred income taxes. The Foundation uses the same accounting method for tax and financial reporting. U.S. generally accepted accounting principles provide accounting and disclosure guidance about positions taken by an entity in its tax returns that might be uncertain. If it is probable that an uncertain tax position will result in a material liability and the amount of the liability can be estimated, then the estimated liability is accrued. If the Foundation were to incur any income tax liability in the future, interest on any income tax liability would be reported as interest expense, and penalties on any income tax would be reported as income taxes. Management has considered its tax positions and believes that all of the positions taken in its federal and state tax returns are considered more likely than not to be sustained upon examination. The Foundation's returns are subject to examination by federal and state taxing authorities, generally for three years and four years, respectively, after they are filed.

*Estimates and Assumptions*

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles 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 financial statements and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Management periodically evaluates estimates used in the preparation of the financial statements for continued reasonableness. Appropriate adjustments, if any, to the estimates used are made prospectively based upon such periodic evaluation. It is reasonably possible that changes may occur in the near term that would affect management's estimates with respect to the fair value of donated goods and services, the fair value of investments, allowance for doubtful accounts and accrued expenses.

*Reclassifications*

The 2015 financial statements have been reclassified, where appropriate, to conform to classifications used in the 2016 financial statements.

*Subsequent Events*

The Foundation has evaluated subsequent events through September 13, 2017, the date the financial statements were available to be issued. There have been no material subsequent events which would require recognition in the financial statements or disclosure in the notes to the financial statements, other than as described in Note 9.

**THE PETCO FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS, CONTINUED**  
April 29, 2017 and April 30, 2016

**3. Long-Term Investments, at Fair Value**

U.S. generally accepted accounting principles establish a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value of the following assets is based on Level 1 measurements. Level 1 fair value measurements are quoted prices in active markets for identical assets that the reporting entity has the ability to access at the measurement date.

Long-term investments, at fair value, consist of the following at:

	<u>April 29, 2017</u>	<u>April 30, 2016</u>
Equities:		
Services	\$ 1,086,479	399,748
Financial	782,661	697,929
Technology and communications	760,886	935,153
Consumer goods	315,372	336,234
Industrial goods	225,758	227,870
Basic Materials	157,002	318,062
Healthcare	<u>67,744</u>	<u>-</u>
Total equities	3,395,902	2,914,996
Certificates of deposit	1,105,157	1,057,341
Bond funds	299,112	155,261
Interest bearing cash	<u>78,977</u>	<u>27,251</u>
Total long-term investments, at fair value	<u>4,879,148</u>	<u>4,154,849</u>

Net investment return is as follows for the years ended:

	<u>April 29, 2017</u>	<u>April 30, 2016</u>
Dividend and interest income	\$ 71,105	58,588
Realized and unrealized gains	650,469	(150,109)
Investment fees	<u>(45,410)</u>	<u>(42,104)</u>
Total net investment (loss) return	<u>\$ 676,164</u>	<u>(133,625)</u>

**THE PETCO FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS, CONTINUED**  
April 29, 2017 and April 30, 2016

**4. Related Party Transactions**

Receivable from Petco of \$2,350,729 and \$2,111,330 at April 29, 2017 and April, 30 2016, respectively, represents cash contributions received from Petco customers and Petco employees not yet remitted in cash to the Foundation as of the fiscal year end date.

The Foundation reimburses Petco under a resource and expense allocation agreement (the Agreement) for expenses incurred to operate the Foundation out of its office space and for administrative services provided. In addition, the Foundation reimburses Petco for the full cost of employees who perform duties solely for the Foundation as well as 75% of the salary of the Executive Director. The cost for all of these expenses for the years ended April 29, 2017 and April 30, 2016, was \$2,667,848 and \$2,986,575, respectively.

Due to Petco of \$291,594 and \$484,442 at April 29, 2017 and April, 30 2016, respectively, represents reimbursable expenses covered under the Agreement in addition to other operating expenses.

As further described in Note 5, the Foundation received in-kind donations from Petco totaling \$1,079,817, for the year ended April, 30 2016.

Program grants totaling \$4,620 and \$122,856 for the years ended April 29, 2017 and April 30, 2016, respectively, were paid to Petco for the creation of and equipping in-store adoption centers operated by Foundation coordinated non-profit adoption organizations utilizing such space and equipment to find animals homes.

Seven members of the Foundation's Board of Directors also serve on boards of organizations which are recipients of program grants from the Foundation. Program grants paid to these organizations totaled \$570,292 and \$564,660 during the years ended April 29, 2017 and April 30, 2016, respectively. Additionally, as further discussed in Note 6, the Foundation has future commitments to two of these organizations totaling \$666,000 as of April 29, 2017.

**5. In-Kind Donations**

The Foundation received other goods and services used in operations which were recorded as contributions and expenses in the accompanying statements of activities at their estimated fair value of \$1,079,817 for the year ended April 30, 2016. There were no such contributions or expenses for the year ended April 29, 2017.

**THE PETCO FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS, CONTINUED**  
April 29, 2017 and April 30, 2016

**6. Joint Costs**

The Foundation conducts activities that include fundraising appeals as well as program and management and general components. These activities include travel, marketing and other constituent relationship activities for both fiscal years 2016 and 2015. Additionally, fiscal year 2016 includes grant management services. The costs of conducting these joint activities which meet the purpose, audience, and content of FASB Accounting Standards Codification 958-720 were \$2,490,360 and \$365,691 for the years ended April 29, 2017 and April 30, 2016. They were comprised of the following for the years ended:

	<u>April 29, 2017</u>	<u>April 30, 2016</u>
Program	\$ 1,086,563	139,966
Fundraising	975,053	148,662
Management and general	<u>428,744</u>	<u>77,063</u>
Total	\$ <u>2,490,360</u>	<u>365,691</u>

**7. Commitments and Contingencies**

The Foundation has entered into commitments with certain charitable organizations and institutions which are contingent upon the organizations fulfilling certain contractual obligations as described in the individual grant agreements.

The future commitment under all grant agreements are as follows at April 29, 2017:

2017	\$ 3,963,000
2018	2,133,000
2019	<u>310,000</u>
	\$ <u>6,406,000</u>

**8. Concentration of Risk**

Contributions

The majority of the contributions received by the Foundation are collected at Petco retail locations.

**THE PETCO FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS, CONTINUED**  
April 29, 2017 and April 30, 2016

**8. Concentration of Risk, Continued**

*Credit Risk*

At April 29, 2017, the Foundation had \$5,076,000 of cash and cash equivalents within financial institutions, a portion of which may be in excess of the federally insured limit. The Foundation has not experienced any such losses and management believes it is not exposed to any significant credit risk on these cash deposits.

*Investment Risk*

The Foundation invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the Foundation's account balances and the amounts reported in the statements of net assets available for benefits.

**9. Subsequent Event**

Subsequent to April 29, 2017, the Foundation entered into an agreement to make a mission related investment in a privately held corporation, representing a 24% ownership interest. Payments of the \$3,000,000 purchase price are subject to certain conditions and will be paid in two \$1,500,000 installments during the fiscal years ending April 28, 2018 and April 27, 2019, respectively.