

November 18, 2008

Key Metrics

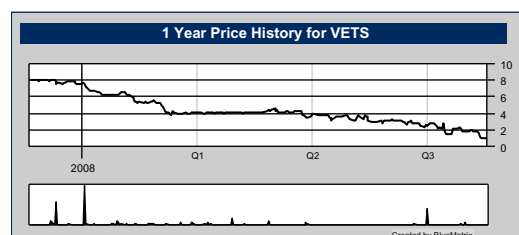
VETS - NASDAQ	\$1.00
Pricing Date	11/14/2008
Price Target	NA
52-Week Range	\$8.04-\$0.90
Shares Outstanding (mm)	23.7
Market Capitalization (\$mm)	\$23.7
3-Mo Average Daily Volume	26,296
Institutional Ownership	26%
Debt/Total Capital	18.2%
ROE	NM
Book Value/Share	\$2.36
Price/Book	0.4x
Dividend Yield	NM
LTM EBITDA Margin	NM

EPS(\$) FY: December

	2007A	Prior 2008E	Curr. 2008E	Prior 2009E	Curr. 2009E
1Q-Mar	(0.21)	--	(0.13)A	--	(0.06)E
2Q-Jun	(0.12)	--	(0.22)A	--	(0.03)E
3Q-Sep	(0.15)	(0.09)E	(0.13)A	0.00E	0.01E
4Q-Dec	(0.16)	--	(0.09)E	0.00E	0.01E
FY	(0.64)	(0.53)E	(0.57)E	--	(0.08)E
P/E	NM		NM		NM

Revenue(\$mm)

	2007A	Prior 2008E	Curr. 2008E	Prior 2009E	Curr. 2009E
1Q-Mar	17.4	--	17.8A	20.6E	18.1E
2Q-Jun	17.7	--	17.9A	24.1E	20.1E
3Q-Sep	17.7	18.8E	17.7A	26.4E	20.5E
4Q-Dec	16.4	18.4E	16.9E	26.1E	19.5E
FY	69.3	73.0E	70.3E	97.2E	78.2E



Company Description: Pet DRx Corporation (www.petdrx.com) provides primary veterinary and specialty care services to companion animals through a network of veterinary hospitals in California. Its services include general medical treatment for pets, including preventive care, such as vaccinations, examinations, spraying, and dental care; and a range of specialized diagnostic and medical services, such as x-ray, ultra-sound internal medicine, surgery, cardiology ophthalmology, dermatology, oncology, and other services.

Pet DRx Corporation

Rating: Hold

3Q Results Below Expectations: Cost Cuts Expected in 2009

Investment Highlights:

- **Pet DRx reports 3Q08 EPS of (\$0.13), \$0.04 below our estimate.**
- **Sales roughly flat Y/Y; net zero hospital additions in the quarter.** 3Q08 sales declined Y/Y 0.2% to \$17.7mm on no net new hospital additions and roughly flat comparable store sales results. As was the case in 2Q, a handful of underperforming units appeared to offset positive results generated from the majority of the hospital base.
- **Acquisition moving slowly.** During the quarter, Pet DRX generated sales from one new hospital yet closed another. As part of its "hub and spoke" strategy, the company consolidated four facilities into two. With a potential increased focus upon currently owned hospital margins, acquisition growth may continue to lag previous expectations.
- **Gross/hospital margins decline both Y/Y and sequentially.** Hospital margins declined sequentially and Y/Y 250 bps and 370 bps, respectively, primarily due to recent new veterinarian hires, one acquisition, and the temporary closure of another facility. Offsetting these cost increases were improved centralized purchasing and lower non-vet salaries. Excluding the temporarily closed hospital and new hires, we believe hospital margins would have been relatively flat at approximately 7%.
- **SG&A expected to be reduced materially in 2009.** Operating costs appear on track to decline to roughly \$14mm in 2008. Management is targeting SG&A of roughly \$9mm in 2009 through cost controls and the elimination of one-time 2008 items such as asset impairment, office relocation, and lower stock-based compensation.
- **Cash from operations (CFO) turns slightly positive; asset sales could boost cash position.** While YTD CFO was (\$10.5mm), sequential results improved with 3Q CFO slightly positive. In addition, the company could add roughly \$3mm to cash through proposed asset sales.
- **Reducing estimates.** We are reducing our FY08 and FY09 sales estimates by \$2.7mm and \$19mm, respectively. The lower estimates reflect fewer acquisitions, weaker comparable store sales, and lower projected hospital margins. Our FY08 EPS estimate declines by \$0.04 while lower-than-anticipated 2009 sales are expected to be offset by additional operating cost reductions, leaving our 2009E EPS unchanged.
- **Cost cuts encouraging but profitability may be a few quarters away: Maintain Hold rating.** While progress appears to have been made, particularly on projected cost cutting initiatives, hospital margins and sales growth remained below past and adjusted expectations. While management has targeted EPS and cash flow profitability in 1Q09, we believe the current environment could make that goal somewhat challenging. We maintain our Hold rating on the shares.

Pet DRx Corp. (VETS)

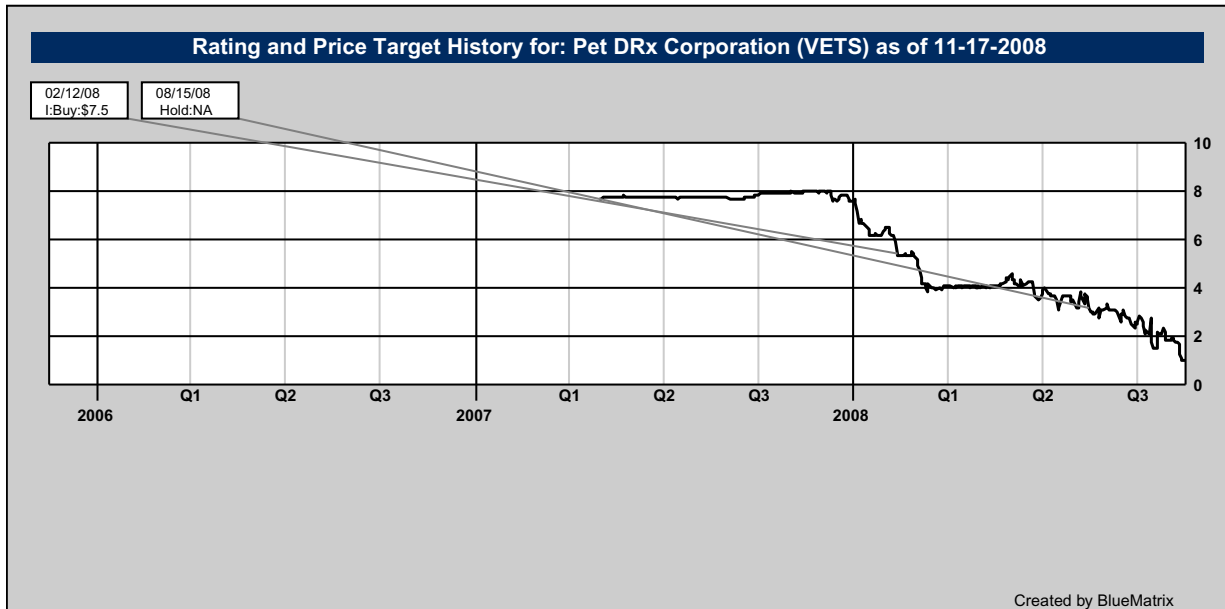
(In Millions, Except Per Share Data)

	FY* 2006	Q1* Mar-07	Q2* Jun-07	Q3* Sep-07	Q4* Dec-07	FY* 2007	Q1 Mar-08	Q2 Jun-08	Q3 Sep-08	Q4E Dec-08	FYE 2008	Q1E Mar-09	Q2E Jun-09	Q3E Sep-09	Q4E Dec-09	FYE 2009
Sales	70.3	17.4	17.7	17.7	16.4	69.3	17.8	17.9	17.7	16.9	70.3	18.1	20.1	20.5	19.5	78.2
<i>% Increase</i>	NA	NA	NA	NA	NA	-1.4%	2.3%	1.1%	-0.2%	2.9%	1.5%	1.5%	12.2%	16.1%	15.4%	11.2%
Cost of Goods Sold	67.4	17.1	16.9	16.2	15.6	65.9	16.1	16.6	16.9	15.7	65.4	16.5	18.1	17.6	16.8	69.0
<i>As % Sales</i>	95.9%	98.0%	95.3%	91.7%	95.2%	95.0%	90.4%	92.9%	95.4%	93.0%	92.9%	91.0%	90.0%	86.0%	86.0%	88.2%
<i>% Increase</i>	NA	NA	NA	NA	NA	-2.3%	-5.6%	-1.5%	3.9%	0.5%	-0.8%	2.1%	8.7%	4.6%	6.7%	5.5%
Gross Profit	2.9	0.4	0.8	1.5	0.8	3.4	1.7	1.3	0.8	1.2	5.0	1.6	2.0	2.9	2.7	9.2
<i>Margin</i>	4.1%	2.0%	4.7%	8.3%	4.8%	5.0%	9.6%	7.1%	4.6%	7.0%	7.1%	9.0%	10.0%	14.0%	14.0%	11.8%
<i>% Increase</i>	124.5%	NA	NA	NA	NA	19.6%	384.9%	53.6%	-45.3%	51.1%	44.7%	-4.6%	57.9%	257.0%	130.8%	86.0%
SG&A	4.7	4.5	3.0	3.7	3.4	14.6	3.8	3.5	3.7	3.0	14.0	2.7	2.5	2.4	2.3	9.9
<i>As % Sales</i>	6.7%	25.9%	16.9%	21.0%	20.4%	21.1%	21.3%	19.6%	20.8%	17.8%	19.9%	14.9%	12.4%	11.7%	11.8%	12.7%
<i>% Increase</i>	NA	NA	NA	NA	NA	NA	-16.2%	17.1%	-1.4%	-10.4%	-4.3%	-28.8%	-28.7%	-34.6%	-23.3%	-29.1%
Operating Profit	(1.8)	(4.2)	(2.2)	(2.2)	(2.6)	(11.2)	(2.1)	(2.2)	(2.9)	(1.8)	(9.0)	(1.1)	(0.5)	0.5	0.4	(0.7)
<i>Margin</i>	-2.6%	-23.9%	-12.2%	-12.7%	-15.6%	-16.1%	-11.7%	-12.5%	-16.2%	-10.8%	-12.8%	-5.9%	-2.4%	2.3%	2.2%	-0.8%
Interest Expense	4.3	1.1	1.1	1.1	1.0	4.3	1.2	2.7	0.3	0.3	4.5	0.3	0.3	0.3	0.3	1.2
Other Income	2.0	0.7	0.7	0.0	0.0	1.3	0.2	-0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Pretax Profit	(4.1)	(4.6)	(2.6)	(3.4)	(3.6)	(14.1)	(3.0)	(5.1)	(3.2)	(2.1)	(13.4)	(1.4)	(0.8)	0.2	0.1	(1.8)
<i>Margin</i>	-5.9%	-26.3%	-14.7%	-19.0%	-21.7%	-20.4%	-16.9%	-28.4%	-17.8%	-12.5%	-19.0%	-7.5%	-3.9%	0.9%	0.7%	-2.3%
Taxes(benefit)	0.2	0.2	0.2	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
<i>Rate</i>	-5.1%	-3.6%	-6.3%	-0.4%	0.0%	-2.4%	-0.3%	-0.8%	-0.4%	0.0%	-0.5%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Income--Oper.	(4.4)	(4.7)	(2.8)	(3.4)	(3.6)	(14.5)	(3.0)	(5.1)	(3.2)	(2.1)	(13.4)	(1.4)	(0.8)	0.2	0.1	(1.8)
<i>Margin</i>	-6.2%	-27.2%	-15.6%	-19.1%	-21.7%	-20.9%	-17.0%	-28.6%	-17.9%	-12.5%	-19.1%	-7.5%	-3.9%	0.9%	0.7%	-2.3%
EPS--Operations	(0.20)	(0.21)	(0.12)	(0.15)	(0.16)	(0.64)	(0.13)	(0.22)	(0.13)	(0.09)	(0.57)	(0.06)	(0.03)	0.01	0.01	(0.08)
Shares Out. Diluted	21.6	22.7	22.7	22.7	22.5	22.5	22.8	23.7	23.7	23.7	23.4	23.7	23.7	23.7	23.7	23.7

Source: Company reports and Morgan Joseph estimates

* Pro Forma adjustments give effect as if XLNT acquired operations January 1, 2006

Required Disclosures



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Morgan Joseph & Co. Inc. makes a market in the shares of VETS.

Morgan Joseph & Co. Inc. has received compensation for investment banking services from Pet DRx Corporation within the past 12 months.

Rating	Investment Banking Services/Past 12 Mos.	
	Percent	Percent
BUY [B]	55.32	36.54
HOLD [H]	43.62	31.71
SELL [S]	1.06	0.00

Meaning of Ratings

- A) Buy means reasonable outperformance relative to the market (Russell 2000) over 12-18 months.
- B) Hold means market-type (Russell 2000) risk adjusted performance; potential source of funds.
- C) Sell means expected to underperform the market (Russell 2000) over 12-18 months.

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