

# DOVER SADDLERY INC

## FORM 10-Q (Quarterly Report)

Filed 11/13/2006 For Period Ending 9/30/2006

Address	525 GREAT ROAD LITTLETON, Massachusetts 01460
Telephone	978-952-8062
CIK	0001071625
Industry	Apparel/Accessories
Sector	Consumer Cyclical

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

**Form 10-Q**

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

**For the Fiscal Quarter Ended September 30, 2006**

**OR**

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

**Commission File Number 000-51624**

**DOVER SADDLERY, Inc.**

**(Exact name of registrant as specified in its charter)**

**DELAWARE**  
**(State of other jurisdiction of**  
**incorporation or organization)**

**04-3438294**  
**(I.R.S. Employer Identification No.)**

**525 Great Road, Littleton, MA 01460**  
**(Address of principal executive offices)**

**(978) 952-8062 (Registrant's telephone number, including area code)**

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 ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

Shares outstanding of the registrant's common stock (par value \$0.0001) at November 9, 2006: 5,074,344

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**DOVER SADDLERY, INC. AND SUBSIDIARIES**  
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**FOR THE QUARTER ENDED SEPTEMBER 30, 2006**

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**PART I—FINANCIAL INFORMATION**  
**Item 1. Condensed Consolidated Financial Statements**  
**DOVER SADDLERY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share amounts)

	September 30, 2006 (Unaudited)	December 31, 2005
<b>Current assets:</b>		
Cash and cash equivalents	\$ 149	\$ 2,887
Accounts receivable	787	160
Inventory	12,952	10,072
Prepaid catalog costs	2,396	1,601
Prepaid expenses and other current assets	1,067	1,136
<b>Total current assets</b>	<b>17,351</b>	<b>15,856</b>
<b>Capital Equipment</b>	<b>2,129</b>	<b>1,729</b>
<b>Other assets:</b>		
Deferred income tax assets	313	254
Goodwill and other assets, net	14,958	13,838
<b>Total other assets</b>	<b>15,272</b>	<b>14,092</b>
<b>Total assets</b>	<b>\$ 34,751</b>	<b>\$ 31,677</b>
<b>Current liabilities:</b>		
Short term bank borrowing and current portion of capital lease obligations	\$ 352	\$ 171
Accounts payable	3,773	2,629
Accrued expenses and other current liabilities	2,296	2,949
Deferred income tax liabilities	373	274
<b>Total current liabilities</b>	<b>6,794</b>	<b>6,023</b>
<b>Long-term liabilities:</b>		
Revolving line of credit	6,600	5,000
Subordinated notes payable	3,000	3,000
Capital lease obligations, net of current portion	168	272
<b>Total long-term liabilities</b>	<b>9,768</b>	<b>8,272</b>
<b>Stockholders' equity:</b>		
Common Stock, par value \$0.0001 per share; 15,000,000 shares authorized, issued 5,074,344 as of September 30, 2006 and December 31, 2005	1	1
Additional paid in capital	43,883	43,883
Accumulated other comprehensive income	14	48
Treasury Stock, 795,865 shares at cost	(6,082)	(6,082)
Retained deficit	(19,627)	(20,468)
	<b>18,189</b>	<b>17,382</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 34,751</b>	<b>\$ 31,677</b>

See accompanying notes.

**DOVER SADDLERY, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME — (unaudited)**  
(in thousands, except per share data)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2006</b>	<b>September 30, 2005</b>	<b>September 30, 2006</b>	<b>September 30, 2005</b>
Net sales	\$ 17,192	\$ 13,959	\$ 52,006	\$ 44,538
Cost of products and merchandising	10,896	8,689	33,252	28,184
Gross margin	6,296	5,270	18,754	16,354
Selling, general and administrative expenses	5,751	4,640	16,685	13,867
Operating income	545	630	2,069	2,487
Interest income	6	13	43	13
Interest expense	254	483	723	1,284
Interest expense, net	248	470	680	1,271
Income before taxes	297	160	1,389	1,216
Income tax provision	99	77	548	581
Net income	<u>\$ 198</u>	<u>\$ 83</u>	<u>\$ 841</u>	<u>\$ 635</u>
<b>Earnings per share:</b>				
<i>Basic</i>	\$ 0.04	\$ 0.02	\$ 0.17	\$ 0.17
<i>Diluted</i>	\$ 0.04	\$ 0.02	\$ 0.16	\$ 0.14
<b>Weighted average shares outstanding:</b>				
<i>Basic</i>	5,074	3,030	5,074	3,055
<i>Diluted</i>	5,191	4,337	5,200	4,503

See accompanying notes.

**DOVER SADDLERY, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)  
(unaudited)

	Nine Months Ended September 30,	
	2006	2005
<b>Operating activities</b>		
Net income	\$ 841	\$ 635
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	439	487
Deferred income taxes	62	169
Amortization of stock based compensation	—	104
Non-cash interest expense and amortization of deferred financing fees	157	412
Changes in current assets and liabilities:		
Accounts receivable	(627)	(774)
Inventory	(2,236)	(1,040)
Prepaid catalog costs and other expenses	(771)	(1,568)
Accounts payable & short term borrowings	1,325	148
Accrued expenses and other current liabilities	(940)	(823)
Net cash used in operating activities	(1,750)	(2,250)
<b>Investing activities</b>		
Acquisition of Dominion	(1,522)	—
Purchases of capital equipment	(733)	(477)
Change in other assets	(205)	21
Cash used in investing activities	(2,460)	(456)
<b>Financing activities</b>		
Borrowings under revolving line of credit	6,250	9,700
Payments under revolving line of credit	(4,650)	(5,000)
Proceeds from issuance of senior subordinated notes	—	8,050
Payments to redeem senior subordinated notes	—	(3,808)
Payments of commitment and financing fees	(24)	(418)
Purchase of treasury stock	—	(6,000)
Proceeds from employee stock option exercises	—	21
Repayment of employee notes receivable	—	282
Payments on capital leases	(104)	(130)
Net cash provided by financing activities	1,472	2,697
Net decrease in cash and cash equivalents	(2,738)	(9)
Cash and cash equivalents at beginning of period	2,887	64
Cash and cash equivalents at end of period	\$ 149	\$ 55
<b>Supplemental disclosure of cash flow information</b>		
Cash paid during the period for:		
Interest	\$ 562	\$ 515
Income taxes	\$ 472	\$ 406
<b>Supplemental disclosure of non-cash financing activities</b>		
Equipment acquired under capital leases	\$ —	\$ 214

See accompanying notes.

**DOVER SADDLERY, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**A. Nature of business and basis of preparation:**

Dover Saddlery, Inc., a Delaware corporation (the “Company”), is a leading specialty retailer and the largest direct marketer of equestrian products in the United States. The Company sells its products through a multi-channel strategy, including catalogs, the Internet, and retail stores located in Massachusetts, New Hampshire, Delaware, Texas, Maryland and Virginia. The Company provides a complete line of products, as well as specially developed private label offerings from its direct marketing headquarters, warehouse, and call center facility in Littleton, Massachusetts.

The accompanying condensed consolidated financial statements comprise those of the Company and its wholly owned subsidiaries, Dover Saddlery, Inc., a Massachusetts corporation, Dover Saddlery Retail, Inc., a Massachusetts corporation, Smith Brothers, Inc., a Texas corporation, and Old Dominion Enterprises, Inc., a Virginia corporation. All inter-company accounts and transactions have been eliminated in consolidation. The accompanying consolidated financial statements as of September 30, 2006 and for the three and nine month periods ended September 30, 2006 and 2005 are unaudited. In management’s opinion, these unaudited consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements for the year ended December 31, 2005 and include all adjustments, consisting of only usual recurring adjustments, necessary for a fair presentation of the results for such interim periods. The results of operations for the nine-month period ended September 30, 2006 are not necessarily indicative of the results expected for the full year ending December 31, 2006.

Certain footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to pertinent rules and regulations, although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading.

**B. Acquisition**

On June 29, 2006 the Company executed a stock purchase agreement with the sole shareholder of Old Dominion Enterprises, Inc., doing business as Dominion Saddlery, to acquire all of the outstanding share capital of Old Dominion Enterprises, Inc. for a net price of \$1.5 million. Dominion Saddlery (Dominion) has been an equestrian retailer serving the Virginia and Maryland market for 30 years through several retail locations. As of September 30, 2006, the purchase price remains subject to a change as a result of the finalization of certain assets and liabilities in accordance with the terms of the purchase agreement. Included in the purchase price was \$.3 million, which was deposited into an escrow account for the sole former shareholder. The escrow is held for any potential indemnification obligations discovered after closing, as well as to secure the seller’s representation on the quality of the inventory. At closing, Dominion became an indirect wholly owned subsidiary of the Company.

The Dominion acquisition has been accounted for in accordance with FASB Statement No. 141 *Business Combinations*. The closing date of the Dominion acquisition was June 29, 2006, and as such, the Company’s consolidated financial statements reflect Dominion’s results of operations only from that date forward.

The preliminary values of the acquired assets and assumed liabilities from the acquisition of Dominion, as presented below, are based upon management’s estimates of fair value as of the date of the acquisition. The excess of the purchase price over the fair value of the net assets acquired was recorded as goodwill as the Company did not identify any specifically identifiable intangible assets. Further, and as discussed above, the final purchase price is subject to certain purchase price adjustments which have not been finalized. The final purchase price allocations will be completed during the fourth quarter and are not expected to have a material impact on the Company’s financial position or results of operations. The preliminary purchase price allocation is as follows (in thousands):

Total purchase price, including closing costs of approximately \$56:	\$ 1,522
Inventories	644
Other Assets	11
Total assets acquired	655
Current liabilities	264
Total liabilities assumed	264
Net assets acquired	391
Excess purchase price over the fair value of net assets acquired	<u>\$ 1,131</u>



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The following table sets forth the unaudited pro forma results of operations of the Company for the nine month periods ended September 30, 2006 and 2005 as if the Company had acquired Dominion as of January 1, 2005. These pro forma amounts do not purport to be indicative of the results that would have actually been obtained if the acquisition had occurred as of January 1, 2005 or that may be obtained in the future.

(Pro forma, un-audited, in thousands, except per share data)	Nine months ended Sept. 30, 2006	Nine months ended Sept. 30, 2005
Net sales	\$53,405	\$46,614
Income before extraordinary items cumulative effect of accounting changes	923	731
Net income	\$ 923	\$ 731
Net income per share	\$ 0.18	\$ 0.16

A roll forward of goodwill from December 31, 2005 to September 30, 2006 is presented below:

Goodwill Balance – December 31, 2005	13,136
Acquisition of Dominion Goodwill	1,131
Goodwill Balance — September 30, 2006	14,267

### C. Accounting for stock-based compensation:

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, *Share Based Payment* (“SFAS 123R”). SFAS 123R supersedes the Company’s previous accounting under Accounting Principles Board Opinion No. 25, *Accounting for Stock issued to Employees* (“APB”), for periods beginning in fiscal 2006. Under APB 25, the Company accounted for stock options under the intrinsic value method. Accordingly, the Company recognized \$104,192 of compensation expense related to employee stock options during the nine months ended September 30, 2005 because the exercise price of such options was less than the fair value of the underlying stock on the grant date. The Company previously disclosed the fair value of its stock options under the provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock Based Compensation* (“SFAS 123”).

Accordingly, the proforma information for the three and nine months ended September 30, 2005 was as follows (in thousands):

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
<b>Net income, as reported:</b>	\$ 83	\$ 635
Add: Employee stock-based compensation expense included in reported net income	7	104
Deduct: Stock-based compensation expense determined under fair value-based method for all employee awards	90	270
Pro forma	\$ 0	\$ 469
<b>Earnings per share:</b>		
Basic	\$ 0.00	\$ 0.12
Diluted	0.00	0.10

The above pro-forma expense was determined under the Black-Scholes calculation using assumptions consistent with those disclosed as of December 31, 2005.

The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company’s fiscal year 2006. The Company’s condensed consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R. The adoption of SFAS 123R had no effect on the results of operations for the nine months ended September 30, 2006 as there were no outstanding unvested options as of December 31, 2005. In addition, there have been no options awarded in the first nine months of 2006.

On October 26, 2006, the Board of Directors approved the grant of 155,529 options, subject to certain restrictions. The options granted have an exercise price equal to the closing price of the common stock as reported on NASDAQ on the date of grant, vest over five years, and expire ten years after grant date subject to earlier termination in the event of employment termination and for incentive stock options granted to 10% holders, which expire five years after the grant date. Related future stock-based compensation expense will be reflected in the consolidated financial statements beginning in the fourth quarter of 2006.

**D. Inventory:**

Inventory consists of finished goods in the Company's mail-order warehouse and retail stores. The Company's inventories are stated at the lower of cost, with cost determined by the first-in, first-out method, or net realizable value. The Company maintains a reserve for excess and obsolete inventory. This reserve was \$70,000 as of September 30, 2006 and December 31, 2005. The Company continuously monitors the salability to ensure adequate valuation of the related merchandise.

**E. Advertising:**

The costs of direct-response advertising materials, primarily catalog production and distribution costs, are deferred in accordance with Statement of Position (SOP) 93-7, *Reporting on Advertising Costs*. These costs are recognized over the period of expected future revenue, which is less than one year. Deferred costs as of September 30, 2006 and December 31, 2005 were \$2.4 million and \$1.6 million respectively. The combined marketing and advertising costs charged to selling, general, and administrative expenses for the nine months ended September 30, 2006 and 2005 were approximately \$6.8 million and \$5.7 million respectively.

**F. Comprehensive Income:**

SFAS No. 130, Reporting Comprehensive Income, establishes standards for reporting and displaying comprehensive income and its components in the consolidated financial statements. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Other than reported net income, the only other item of comprehensive income is the effectively hedged interest rate swap adjustment.

	<b>For the Nine Months ended September 30 (in thousands)</b>	
	<b>2006</b>	<b>2005</b>
Net income	\$ 841	\$ 635
Unrealized (loss)/gain on interest rate swap	(34)	64
Net comprehensive income	\$ 807	\$ 699

**G. Earnings per share:**

A reconciliation of the number of shares used in the calculation of basic and diluted net income per share is as follows (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2006</b>	<b>September 30, 2005</b>	<b>September 30, 2006</b>	<b>September 30, 2005</b>
Basic weighted average common shares outstanding	5,074	3,030	5,074	3,055
Add: Dilutive effect of convertible preferred stock	—	1,115	—	1,264
Dilutive effect of assumed stock option and warrant exercises less potential incremental shares purchased under the treasury method	117	192	126	184
Diluted weighted average common shares outstanding	<u>5,191</u>	<u>4,337</u>	<u>5,200</u>	<u>4,503</u>

**Earnings per share:**

<i>Basic</i>	\$ 0.04	\$ 0.02	\$ 0.17	\$ 0.17
<i>Diluted</i>	\$ 0.04	\$ 0.02	\$ 0.16	\$ 0.14

A reconciliation of the net income available to common stockholders used in the calculation of basic and diluted net income per share is as follows (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2006</b>	<b>September 30, 2005</b>	<b>September 30, 2006</b>	<b>September 30, 2005</b>
Net Income:	\$ 198	\$ 83	\$ 841	\$ 635
Preferred stock dividends	—	(33)	—	(113)
Net Income available to common stockholders	<u>198</u>	<u>50</u>	<u>841</u>	<u>522</u>

### H. Debt:

#### *Revolving Credit Facility*

The \$16,000,000 revolving credit facility, of which up to \$2,000,000 can be in the form of letters of credit, shall bear interest at the base rate, announced from time to time by the bank plus an applicable margin determined by the Company's funded debt ratio. As of September 30, 2006 and December 31, 2005, the bank rates were 8.25%. The applicable margins were 0.00% and 1.00%, respectively. Interest is payable quarterly on the last business day of each fiscal quarter. As of September 30, 2006 and December 31, 2005, \$1,600,000 and \$0, respectively, bore interest at the base rate plus margin.

At its option, the Company may have all or a portion of the unpaid principal under the credit facility bear interest at a one, two, three, or six month LIBOR rate options. The LIBOR rate was 5.33% and 4.38% at September 30, 2006 and December 31, 2005 respectively, plus an applicable margin determined by the Company's funded debt ratio. The margins were 1.75% and 3.25% at September 30, 2006 and December 31, 2005 respectively, and were fixed for the LIBOR rate option period. Interest related to LIBOR rate options are payable at the maturity of the LIBOR agreements. As of September 30, 2006 and December 31, 2005, \$5,000,000 bore interest at the one month LIBOR rate option.

The Company is obligated to pay commitment fees of 0.25% per annum on the average daily, unused amount of the line of credit during the preceding quarter on the revolving credit facility. All assets of the Company collateralize the revolving credit facility. Under the terms of the credit facility, the Company is subject to certain covenants including, among others, maximum funded debt ratios, operating cash flows, profitability, and capital expenditures. At September 30, 2006, the Company was in compliance with all covenants. The revolving line of credit is due in full in September 2008.

At September 30, 2006 and December 31, 2005, the Company had the ability to borrow \$16,000,000 on the revolving line of credit, of which \$6,600,000 was outstanding on September 30, 2006 and \$5,000,000 was outstanding on December 31, 2005.

#### *Subordinated Notes Payable*

In September 2005, the Company issued \$8.05 million of senior subordinated debt whereby the additional funds were used to pay off the previous subordinated note payable. The note bears interest at the rate of 11.5% payable monthly. The note may be prepaid at the Company's option at 104% or 105% of its principal amount until September 16, 2007 or 2008, respectively. The note is payable at 106% of its principal amount by September 16, 2009.

Under the terms of the credit facility, the Company is subject to certain covenants including, among others, maximum funded debt ratios, operating cash flows, profitability, and capital expenditures. At September 30, 2006 the Company was in compliance with all covenants. The remaining balance was \$3,000,000 at September 30, 2006 and December 31, 2005.

### I. Income Taxes

The effective tax rates recorded for the year to date periods ended September 30, 2006 and 2005 were recorded based upon management's best estimate of the effective tax rates for the entire respective years. The change in the effective tax rate from 48% for the first nine months of 2005 to 39% for the same period in 2006 is due to the reduction of certain income tax liabilities no longer deemed necessary, as well as non-deductible stock based compensation in 2005.

### J. Related Party Transactions

In October of 2004, the Company entered into a lease agreement with a minority stockholder. The agreement, which relates to the Plaistow, NH retail store, is a five year lease with options to extend for an additional fifteen years. For the year ended December 31, 2005 the Company paid and expensed \$160,000 in connection with the lease. For the nine months ended September 30, 2006 the Company paid and expensed \$ 138,000. In addition, a related deposit of \$18,750 is recorded as prepaid expenses and other current assets.

In order to expedite the efficient build-out of leasehold improvements in its new retail stores, the Company utilizes the services of a real estate development company owned by a non-executive Company employee and minority stockholder to source construction services and retail fixtures. Total payments for the nine months ended September 30, 2006, consisting primarily of reimbursements for materials and outside labor, for the fit-up of five stores were \$283,000. Reimbursements in the prior fiscal year were \$91,000.

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### K. Commitments and contingencies:

#### *Lease commitments*

The Company leases its facilities, as well as certain fixed assets that may be purchased for a nominal amount on the expiration of the leases, under non-cancelable operating and capital leases that extend through 2009. The facility leases, which may be renewed for periods ranging from one to five years, include fixed rental agreements as well as agreements with rent escalation clauses.

In connection with retail locations, the Company enters into various operating lease agreements, which will further escalate rental payments in the future. The effects of variable rent disbursements have been expensed on a straight-line basis over the life of the lease in accordance with SFAS No. 13 "Accounting for Leases". As of September 30, 2006 and December 31, 2005 there was approximately \$63,000 and \$46,000 of deferred rent recorded in other current liabilities.

#### *Contingencies*

In February 2006, following the close of its 2005 fiscal year, the Company received an invoice for \$2.1 million from Goldsmith, Agio, Helms & Linner LLC (GAH) seeking a success fee for financial advisory services purportedly due in connection with the Company's initial public offering (IPO). In a cover letter accompanying its invoice, GAH asserted that if its invoice was not paid, GAH would pursue its claim in arbitration (herein, the "GAH Claim").

The Company has communicated emphatically to GAH that GAH did not have a valid claim for a success fee or other compensation in connection with the Company's IPO. Nonetheless, on March 24, 2006, GAH filed a demand for arbitration with the American Arbitration Association for \$2.1 million (plus interest and fees).

The Company denies any and all liability for the GAH claim; plans to vigorously defend against such claim; and has filed a \$3.0 million counterclaim against GAH for consequential and enhanced damages (plus costs and legal fees) that we suffered as the result of GAH's breach of contract and of duties to us. Thus, no amounts have been accrued as of September 30, 2006 and December 31, 2005.

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*This Quarterly Report on Form 10-Q, including the following discussion, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve substantial risks and uncertainties. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the generality of the foregoing, the words "projected," "anticipated," "planned," "expected" and similar expressions are intended to identify forward-looking statements. In particular, statements regarding future financial targets or trends are forward-looking statements. Forward-looking statements are not guarantees of our future financial performance, and undue reliance should not be placed on them. Our actual results, performance or achievements may differ significantly from the results, performance or achievements discussed in or implied by the forward-looking statements. Factors that could cause such a difference detailed in "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005 ("fiscal 2005"). We disclaim any intent or obligation to update any forward-looking statements*

#### **Overview**

We are a leading specialty retailer and the largest direct marketer of equestrian products in the U.S. For over 20 years, Dover Saddlery has been a premier upscale marketing brand in the English-style riding industry. We sell our products through a multi-channel strategy, including catalogs, the Internet and retail stores. This multi-channel strategy has allowed us to use catalogs and our proprietary database of nearly two million names of equestrian enthusiasts as a primary marketing tool to increase catalog sales and to drive additional business to our e-commerce websites and retail stores.

We are committed to expanding our retail store channel. On June 29, 2006, we acquired Dominion Saddlery, the largest equestrian retailer in the Virginia and Maryland market, which operates four stores. This strategic acquisition provides access to critical leased locations and established customer relationships, as well as the elimination of a significant retail competitor. Since the acquisition, and for the next four months, we will be converting, expanding, and launching these stores as Dover Saddlery stores, giving us the premier position in one of the most important regional markets in the country. On September 29, 2006, we successfully opened our newest Dover store in Hunt Valley, Maryland.

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### Results of Operations

The following table presents our unaudited condensed consolidated statements of operations expressed as a percentage of net sales:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products and merchandising	63.4	62.2	63.9	63.3
Gross margin	36.6	37.8	36.1	36.7
Selling, general and administrative expenses	33.5	33.2	32.1	31.1
Operating income	3.2	4.6	4.0	5.6
Interest income	0.1	0.1	0.1	0.0
Interest expense	1.5	3.5	1.4	2.9
Interest (income) expense, net	1.4	3.4	1.3	2.9
Income before taxes	1.8	1.2	2.7	2.7
Income tax provision	0.6	0.6	1.1	1.3
Net income	1.2%	0.6%	1.6%	1.4%

The following table presents certain selected operating data on an unaudited basis:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
<b>Net sales:</b>				
Revenue, net — direct	\$ 13,433	\$ 11,579	\$ 43,289	37,897
Revenue, net – retail stores	3,759	2,380	8,717	6,641
Revenue, net – total	\$ 17,192	\$ 13,959	\$ 52,006	44,538
<b>Other operating data:</b>				
Number of retail stores(2)	5	4	5	4
Capital expenditures	571	129	733	477
Gross profit margin	36.6%	37.8%	36.1%	36.7%
EBITDA (1)	687	802	2,508	3,078
EBITDA margin (1)	4.00%	5.75%	4.82%	6.91%

- (1) When we use the term “EBITDA”, we are referring to net income minus interest income plus interest expense, income taxes and depreciation and amortization. We present EBITDA because we consider it an important supplemental measure of our performance and believe it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry.
- (2) Does not include the three Dominion stores open for liquidation of inventory during Q3, or the fourth store closed for renovation. Includes new Dover store in Hunt Valley, MD, opened September 29, 2006.

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### *Comparison of Third Quarter Fiscal 2006 to Third Quarter Fiscal 2005*

#### *Revenues*

Our total revenues increased 23.2% to \$17.2 million in the third quarter of 2006, from \$14.0 million in 2005, a total increase of \$3.2 million. Revenues in our direct sales channel increased \$1.9 million, or 16.0%, and revenues in our retail store channel increased \$1.4 million, or 57.9%. The increase in revenues from our direct sales channel was attributed to higher unit volumes through both the catalog and the internet channels, and from both the Dover Saddlery and the Smith Brothers brands. The increase in revenues from our retail sales channel was due primarily to the acquisition of the Dominion stores.

#### *Gross Profit*

Gross profit increased 19.5% to \$6.3 million in the third quarter of 2006, from \$5.3 million in the prior year Q3. Gross profit as a percentage of revenues decreased to 36.6% in 2006, from 37.8% of revenues in 2005. The increase of \$1.0 million in gross profit was due to increased revenues in both our direct and retail sales channels. The decrease in gross profit as a percentage of revenues was attributable to variations in overall product mix, as well as increased freight costs.

#### *Selling, General and Administrative*

Selling, general and administrative expenses increased to \$5.8 million (33.4% of revenues) in the third quarter of 2006, from \$4.6 million (33.2% of revenues) in 2005. The \$1.2 million increase includes \$0.4 million in marketing costs, primarily catalog expense, internet advertising and new store support designed to drive increased revenues. Labor and related costs increased approximately \$0.1 million due to retail expansion. New public company costs, consisting of legal, audit, and insurance fees increased by \$0.3 over the third quarter of 2005. Facility costs for new retail store space increased \$0.1 million in the third quarter of 2006.

#### *Interest Expense*

Interest expense, including amortization of deferred financing costs attributed to our subordinated debt and revolving credit facility, decreased 47% to \$0.3 million in the third quarter of 2006, compared to \$0.5 million in 2005. Our debt levels were reduced substantially as the result of the interim application of the Company's proceeds from the IPO, resulting in decreased interest expense for both senior and remaining subordinated debt.

#### *Income Tax Provision*

The provision for income taxes was \$0.1 million in the third quarter of 2006, reflecting an effective tax rate of 33%, as compared to \$0.1 million in 2005, reflecting an effective tax rate of 48%. The effective tax rates for the year to date periods were recorded based upon management's best estimates of the rates for the entire respected years, and adjusted each quarter. The lower effective rate in 2006 versus 2005 is attributable to the reduction of certain income tax liabilities no longer deemed necessary.

#### *Net Income*

Net income for the third quarter was \$198,000, an increase of \$115,000 over the \$83,000 net income achieved in the third quarter of 2005. This increase is due primarily to increased revenues and reduced interest costs. Resulting earnings per share, fully diluted, increased to \$.04 from the prior year of \$.02.

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### ***Comparison of the Nine Months Ended September 30, 2006 to the Nine Months Ended September 30, 2005***

#### *Revenues*

Our total revenues increased 16.8% to \$52.0 million in the nine months ended in 2006, from \$44.5 million in 2005, a total increase of \$7.5 million. Revenues in our direct sales channel increased \$5.4 million, or 14.2%, and revenues in our retail store channel increased \$2.1 million, or 31.3%. The increase in revenues from our direct sales channel was attributed to higher unit volumes through both catalog and the Internet, and from both the Dover Saddlery and the Smith Brothers brands. Increases in our retail revenues were due primarily to the Dominon acquisition and Plaistow.

#### *Gross Profit*

Gross profit increased 14.7% to \$18.8 million for the nine months ended in 2006, from \$16.4 million in 2005. Gross profit as a percentage of revenues decreased slightly to 36.1% for the nine months ended in 2006, from 36.7% of revenues in 2005. The increase of \$2.4 million in gross profit was due to increased revenues, primarily in both our retail and direct sales channels. The slight decrease in gross profit as a percentage of revenues was attributable to variations in both overall product mix and the sales mix of our catalogs, as well as increased freight costs.

#### *Selling, General and Administrative*

Selling, general and administrative expenses increased to \$16.7 million (32.0% of revenues) for the nine months ended in 2006, from \$13.9 million (31.1% of revenues) in 2005. The \$2.8 million increase includes \$1.1 million in marketing costs, primarily catalog expense, internet advertising and new store support designed to drive increased revenues. Labor and related costs increased approximately \$0.3 million to support the new retail stores, increased direct channel sales and increased merchandising support functions. New public company costs, consisting of legal, audit, and insurance fees increased by \$0.8 over the nine months ended in 2005.

#### *Interest Expense*

Interest expense, including amortization of deferred financing costs attributed to our subordinated debt and revolving credit facility, decreased 44% to \$0.7 million for the nine months ended in 2006, compared to \$1.3 million in 2005. Our debt levels were reduced substantially as the result of the interim application of the company proceeds from the IPO, resulting in decreased interest expense for both senior and remaining subordinated debt.

#### *Income Tax Provision*

The provision for income taxes was \$0.6 million for the nine months ended in 2006, reflecting an effective tax rate of 39%, as compared to \$0.6 million in 2005, reflecting an effective tax rate of 48%. The lower effective rate in 2006 versus 2005 is due to the reduction of certain income tax liabilities no longer deemed necessary.

#### *Net Income*

Net income for the nine months ended in 2006 was \$841,000, an increase of 32%, or \$206,000 over the \$635,000 net income achieved in 2005. This increase is due to the substantial growth in our direct and retail revenues, our investment in marketing, and reduced stock based compensation and interest costs, all partially offset by increased freight costs, as well as costs of being a public company. Our 2006 earnings per share, fully diluted, increased to \$.16 from the prior year of \$.14.

#### ***Seasonality and Quarterly Fluctuations***

Since 2001, our quarterly product sales have ranged from a low of approximately 20% to a high of approximately 32% of any calendar year's results. The beginning of the spring outdoor riding season in the northern half of the country has typically generated a slightly stronger second quarter of the year, and the holiday buying season has generated additional demand for our normal equestrian product lines in the fourth quarter of the year. Revenues for the first and third quarters of the calendar year have tended to be somewhat lower than the second and fourth quarters. We anticipate that our revenues will continue to vary somewhat by season.

The timing of our new retail store openings has had and is expected to continue to have a significant impact on our quarterly results. We will incur one-time expenses related to the opening of each new store. As we open new stores, (i) revenues may spike and then settle, and (ii) pre-opening expenses, including such expenses as occupancy and management overhead, are incurred, which may not be offset by correlating revenues during the same financial reporting period. As a result of these factors, new retail store openings may result in temporary declines in operating profit, both in dollars and as a percentage of sales.

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### *Liquidity and Capital Resources*

In 2005, we generated net proceeds of \$12.4 million through our initial public offering, which enhanced our other primary sources of liquidity which are cash flows generated from our operations and availability under our revolving credit facility. In addition to the \$2.8 million of remaining cash at December 31, 2005 and the additional credit availability resulting from the application of proceeds from the offering to the outstanding balances under our revolving credit facility, we intend to use the primary sources of liquidity to fund new retail store locations, our working capital requirements, capital expenditure requirements and third-party debt service requirements. We may in the future need to obtain additional financing from banks, or through public offerings or private placements of debt or equity securities, strategic relationships or other arrangements.

#### *Operating Activities*

The cash utilized in our operating activities in the nine months ended in 2006 was \$1.8 million, with cash flow consisting primarily of net income and non-cash expenses totaling \$1.3 million, increased by accounts payable of \$1.3 million and offset by credit card receivables in transit of \$0.6, increases in prepaid catalog expenses of \$0.8 million, reductions of accrued expenses and gift certificates of \$0.9 million, and inventory increases of \$2.2 million attributable to retail growth. In the nine months ended in 2005, cash utilized by our seasonal operating activities was primarily due to net income and non-cash expenses of \$1.4 million, which were offset by increases in prepaid expenses of \$1.6 million, credit card receivables of \$0.8 million, and inventory of \$1.0 million, due to the opening of the new Plaistow, NH store.

#### *Investing Activities*

Cash used in our investing activities was \$2.5 million in the nine months ended in 2006 and \$0.5 million in the nine months ended in 2005. The Dominion acquisition was \$1.5 million in 2006. Additional investment activities throughout these periods represent the purchase of capital equipment in support of our growth, including leasehold improvements, computer equipment, internal use software, furniture and fixtures, and the purchase of other assets and related deposits. Increases in investment activities can be expected in the balance of 2006 and in future years to fit out planned new retail stores with leasehold improvements, computer equipment, fixtures, furniture and other assets.

#### *Financing Activities*

Net cash provided by our financing activities was \$1.5 million in the nine months ended in 2006, and \$2.7 million was provided in the nine months ended in 2005. In the nine months ended in 2006, we funded our seasonal operating activities and investing activities with the remaining cash made available from the Company's portion of our offering, as well as net borrowings under our revolving credit facility. The proceeds of our offering remain available through our ability to draw on our senior credit facility. In the nine months ended in 2005, net cash provided by our financing activities of \$2.7 million consisted primarily of net borrowings under our revolving credit facility.

#### *Revolving Credit Facility*

In September 2005, we renewed and increased our revolving credit facility with Bank of America, N.A., under which we can borrow up to \$16.0 million, including \$2.0 million for letters of credit. We amended that facility on March 30, 2006 to adjust various covenants. Interest accrues at a variable rate based on both prime and published LIBOR rates. The credit facility expires on September 16, 2008 at which time all advances will be immediately due and payable. As of September 30, 2006, the revolving credit facility borrowing limit was \$16.0 million and the amount outstanding under the credit facility was \$6.6 million at a blended rate of 6.0% and the unused amount available was \$9.4 million. We maintain a derivative financial instrument to hedge the risk of interest rate fluctuations on a portion of our outstanding bank debt. Borrowings are secured by substantially all of our assets. Under the terms of our credit facility, we are subject to certain covenants including, among others, maximum funded debt ratios and capital expenditures, minimum operating cash flows and profitability, and certain acquisition related activity. At September 30, 2006, we were in compliance with all covenants under the credit facility. If a default ever occurs, the bank may require that we repay all amounts then outstanding. Any amounts which we may be required to repay prior to a scheduled repayment date, however, would reduce funds that we could otherwise allocate to other opportunities that we consider desirable.

#### *Senior Subordinated Note and Warrant*

On September 16, 2005, we closed an Amended and Restated Senior Subordinated Note and Warrant Purchase Agreement with Patriot Capital Funding, Inc., which provided for our issuance of a senior subordinated note payable, which is due in full on September 16, 2009 for aggregate proceeds of \$8.05 million. Of such proceeds, \$3.5 million was used to pay off a previously existing subordinated note payable and \$4.0 million was used to pay a portion of a \$6.0 million purchase price of 795,865 shares of our common stock. The note is a general senior subordinated obligation, is subordinated in right of payment to our existing and future senior debt, ranks equal in right of payment with any of our future senior subordinated debt and is senior in right of payment to any of our future subordinated debt. Interest at an annual rate of 11.5% is payable monthly on the fifth business day of the month. Prepayment on the principal amount due under the note may voluntarily be made at any time in multiples of \$100,000, plus accrued and unpaid interest and a prepayment fee equal to the principal amount prepaid multiplied by 4.0% if prepayment is made prior to September 16, 2007, 5.0% if prepayment is made prior to September 16, 2008 and 6.0% if prepayment is made prior to September 16, 2009. Mandatory prepayment is required upon a change in control. Simultaneously with the issuance of this note, we issued a warrant to Patriot Capital Funding, Inc. exercisable at any time after March 31, 2006 for up to 30,974 shares of our common stock at an exercise price of \$0.00759 per share. In December 2005, we utilized proceeds from our public offering to prepay \$5.1 million of the debt

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due under the note, leaving a balance of \$3,000,000. As of September 30, 2006 the balance of the Subordinated Note was \$3,000,000, and we were in compliance with all of its covenants.

### *Working Capital and Capital Expenditure Needs*

We believe our existing cash, cash equivalents, expected cash to be provided by our operating activities, and funds available through our revolving credit facility (as increased by the net proceeds from our public offering) will be sufficient to meet our currently planned working capital and capital expenditure needs over at least the next 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our marketing and sales activities, the expansion of our retail stores, the acquisition of new capabilities or technologies and the continuing market acceptance of our products. To the extent that existing cash, cash equivalents, cash from operations and cash from our revolving credit facility under the conditions and covenants of our credit facilities are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. As part of our growth strategy in the future, we may seek investments in or acquisitions of other businesses, services, or technologies, which could also require us to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all.

### **Contractual Obligations**

We generally do not enter into binding purchase commitments. Our principal commitments consist of obligations under our revolving credit facility and leases for our headquarters and distribution facility, as well as our retail stores and miscellaneous office space. The following table describes our commitments to settle contractual obligations in cash as of September 30, 2006, unless otherwise noted:

	Payments Due by September 30,					Total
	2007	2008	2009	2010	2011	
	(in thousands)					
Short-term bank borrowings	\$ 211	\$ —	\$ —	\$ —	\$ —	\$ 211
Capital leases	140	103	61	5	—	309
Operating leases	1,577	1,563	1,483	1,152	1,829	7,604
Revolving credit facility	—	6,600	—	—	—	6,600
Senior subordinated notes	—	—	3,000	—	—	3,000
Total	\$1,928	\$8,266	\$4,544	\$1,157	\$1,829	\$17,724

### **Critical Accounting Policies and Estimates**

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our actual results may differ from these estimates. A summary of significant accounting policies and a description of accounting policies that are considered critical may be found in our 2005 Annual Report on Form 10-K, filed on March 30, 2006, in Note A of the Notes to the Consolidated Financial Statements and the “Critical Accounting Policies” section of Management’s Discussion and Analysis of Financial Condition and Results of Operations.

### **Recent Accounting Pronouncements**

In December 2004, the FASB issued SFAS No. 123R, which requires the measurement of all share-based payments to employees, including grants of employee stock options, using a fair-value-based method and the recording of such expense in our consolidated statement of operations. The accounting provisions of SFAS No. 123R are effective for fiscal years beginning after June 15, 2005, and we have adopted SFAS No. 123R for our fiscal quarter beginning January 1, 2006. The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company’s fiscal year 2006. The Company’s condensed consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R. The adoption of SFAS 123R had no effect on the results of operations for the nine months ended September 30, 2006 as there were no outstanding unvested options for the nine months ending September 30, 2006. In addition, there have been no options awarded in the first nine months of 2006. On October 26, 2006, the Board of Directors approved the grant of 155,529 options, subject to certain restrictions. The options granted have an exercise price equal to the closing price of the common stock as reported on NASDAQ on the date of grant, vest over five years, and expire ten years after grant date subject to earlier termination in the event of employment termination and for incentive stock options granted to 10% holders, which expire five years after the grant date. The future stock-based compensation expense will be reflected in the consolidated financial statements beginning in the fourth quarter of 2006.

In June 2006, the FASB issued FASB Interpretation No. (“FIN”) 48, “Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109”, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 will be effective for fiscal years beginning after December 15, 2006. The Company has not yet completed its evaluation of the impact of adoption on the Company’s financial position or results of operations.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

At September 30, 2006, there had not been a material change in any of the market risk information disclosed by us in our Annual Report on Form 10-K for the year ended December 31, 2005. More detailed information concerning market risk can be found in Item 7A under the sub-caption “Quantitative and Qualitative Disclosures about Market Risks” of the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations” on pages 40-41 of our Annual Report on Form 10-K for the year ended December 31, 2005 .

Our objective in managing our long-term exposure to interest rate and foreign currency rate changes is to limit the material impact of the changes on cash flows and earnings and to lower our overall borrowing costs. We have calculated the effect of a 10% change in interest rates over a month for both our debt obligations and our marketable securities investments and determined the effect to be immaterial. We do not foresee or expect any significant changes in the management of foreign currency or interest rate exposures or in the strategies we employ to manage such exposures in the near future.

#### *Foreign Currency Risk*

Nearly all of our revenues are derived from transactions denominated in U.S. dollars. We purchase products in the normal course of business from foreign manufacturers. As such, we have exposure to adverse changes in exchange rates associated with those product purchases, but this exposure has not been significant.

#### *Interest Rate Sensitivity*

We had cash and cash equivalents totaling \$0.1 million at September 30, 2006. The unrestricted cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. Some of the securities in which we invest, however, may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investments to fluctuate. To minimize this risk in the future, we intend to maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, money market funds, debt securities and certificates of deposit. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. As of September 30, 2006, all of our investments were held in money market and other short-term investment accounts.

Our exposure to market risk also relates to the increase or decrease in the amount of interest expense we must pay on our outstanding debt instruments, primarily certain borrowings under our revolving credit facility. The advances under this revolving credit facility bear a variable rate of interest determined as a function of the prime rate and the published LIBOR rate at the time of the borrowing. We maintain a derivative financial instrument to hedge the risk of interest rate fluctuations on a portion of our outstanding bank debt. If interest rates were to increase by one percent, the additional interest expense as of June 30, 2006 would be approximately \$50,000 annually prior to any potential benefit from our interest rate protection. At September 30, 2006 there was \$6.6 million outstanding under our revolving credit facility.

### Item 4. Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2006, to assure that information required to be disclosed by us in the reports we file or submit under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms.

Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2006, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

We maintain certain internal controls over financial reporting that are appropriate, in management’s judgment with similar cost-benefit considerations, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. No change in our internal control over financial reporting occurred during the fiscal quarter ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

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## PART II—OTHER INFORMATION

### Item 1. Legal Proceedings

As previously disclosed in Item 3 under the caption “Legal Proceedings” on pages 23-24 of our Annual Report on Form 10-K for the fiscal year ending December 31, 2005, the Company received in February 2006 an invoice for \$2,101,977.76 from Goldsmith, Agio, Helms & Linner LLC (GAH) seeking a success fee for financial advisory services purportedly due in connection with the Company’s initial public offering (IPO). GAH asserted that if its invoice was not paid, GAH would pursue its claim in arbitration (herein, the “GAH Claim”).

We communicated emphatically to GAH that GAH did not have a valid claim for a success fee or other compensation in connection with the Company’s IPO. Nonetheless, on March 24, 2006, GAH filed a demand for arbitration with the American Arbitration Association for \$2.1 million, plus interest and fees. In April 2006, the Company answered the arbitration demand, denying liability on all claims, and filed a \$3 million counterclaim against GAH for consequential and enhanced damages (plus costs and legal fees) that we suffered as the result of GAH’s breach of contract and of duties to us. We deny any and all liability for the GAH Claim, plan to vigorously defend against such claim, and plan to vigorously pursue our counterclaim.

From time to time, we may be exposed to litigation relating to our products and operations. Except as described above, we are not currently engaged in any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on our financial conditions or results of operations.

### Item 1A. Risk Factors

An investment in our common stock involves a high degree of risk. You should carefully consider the specific risk factors listed under Part I, Item 1A of our Annual Report on Form 10-K filed on March 30, 2006, together with all other information included or incorporated in our reports filed with the Securities and Exchange Commission. Any such risks may materialize, and additional risks not known to us, or that we now deem immaterial, may arise. In such event, our business, financial condition, results of operations or prospects could be materially adversely affected. If that occurs, the market price of our common stock could fall, and you could lose all or part of your investment.

This Quarterly Report on Form 10-Q includes or incorporates 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 use of the words “believes”, “anticipates”, “plans”, “expects”, “may”, “will”, “would”, “intends”, “estimates” and other similar expressions, whether in the negative or affirmative. We cannot guarantee that we actually will achieve the plans, intentions or expectations disclosed in the forward looking statements made. We have included important factors in the cautionary statements below that we believe could cause actual results to differ materially from the forward-looking statements contained herein. The forward-looking statements do not reflect the potential impact of any future acquisitions, mergers or dispositions. We do not assume any obligation to update any forward-looking statements contained herein. In addition to the list of significant risk factors set forth in the Company’s Annual Report on Form 10-K for the fiscal year ending December 31, 2005, the following supplemental information might also be considered material in evaluating the risks of our business and an investment in our common stock:

*Our market is highly competitive and we may not continue to compete successfully.* We compete in a highly competitive marketplace with a variety of retailers, dealers and distributors. The equestrian products market is highly fragmented with approximately 10,000 retail store locations nationwide. Many of these are small businesses that have a loyal customer base. We may therefore not be able to generate sufficient sales to support our new retail store locations. We also compete directly with State Line Tack, which is owned by PetSmart and has greater financial resources than we have. There are also a significant number of sporting goods stores, mass merchandisers and other better funded companies that could decide to enter into or expand their equestrian products offerings. In addition, if our competitors reduce their prices, we may have to reduce our prices in order to compete. We may also be forced to increase our advertising or mail a greater number of catalogs in order to generate the same or even lower level of sales. Any one of these competitive factors could adversely affect our revenues and profitability. It is possible that increased competition or improved performance by our competitors may reduce our market share, may reduce our profit margin, and may adversely affect our business and financial performance in other ways.

*We may be unable to continue to open new stores and enter new markets successfully.* An important part of our business plan is to increase our number of stores and enter new geographic markets. We opened one store last year and currently plan to open approximately up to two new stores in the second half of 2006. For our growth strategy to be successful, we must identify and lease or buy favorable store sites, hire and train associates and adapt management and operational systems to meet the needs of our expanded operations. These tasks may be difficult to accomplish successfully. If we are unable to open new stores as quickly as planned, our future sales and profits could be materially adversely affected. Even if we succeed in opening new stores, these new stores may not achieve the same sales or profit levels as our existing stores. Also, our expansion strategy includes opening new stores in markets where we already have a presence so we can take advantage of economies of scale in marketing, distribution and supervision costs. However, these new stores may result in the loss of sales in existing stores in nearby areas.

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*Our growth may strain operations, which could adversely affect our business and financial results.* Our business has grown and continues to grow through organic growth and acquisitions. Accordingly, sales, number of stores, number of countries in which we conduct business and number of associates have grown and will likely continue to grow. This growth places significant demands on management and operational systems. If we are not successful in continuing to support our operational and financial systems, expanding our management team and increasing and effectively managing our associate base, this growth is likely to result in operational inefficiencies and ineffective management of the business and associates, which may in turn adversely affect our business and financial performance.

*Our operating results may be impacted by changes in the economy.* Our operating results are directly impacted by the health of and confidence in the North American economy. Current economic conditions may adversely affect our business and our results of operations.

*Our stock price may fluctuate based on market expectations.* The public trading of our stock is based in large part on market expectations that our business will continue to grow and that we will achieve certain levels of net income. If the securities analysts that regularly follow our stock lower their ratings or lower their projections for future growth and financial performance, the market price of our stock is likely to drop significantly. In addition, if our quarterly financial performance does not meet the expectations of securities analysts, our stock price would likely decline. The decrease in the stock price may be disproportionate to the shortfall in our financial performance.

*Our quarterly operating results are subject to significant fluctuation.* We experience seasonal fluctuation in our revenues and operating results. We typically realize a higher portion of our revenues and operating results during the fourth quarter. As a result of this seasonality, we believe that quarter to quarter comparisons of our operating results are not necessarily meaningful and that these comparisons cannot be relied upon as indicators of future performance. Our operating results have fluctuated from quarter to quarter in the past, and we expect that they will continue to do so in the future. Our earnings may not continue to grow at rates similar to the growth rates achieved in recent years and may fall short of either a prior fiscal period or investors' expectations. Factors that could cause these quarterly fluctuations include the following: the extent to which sales in new stores result in the loss of sales in existing stores; accrual or pre-opening store expenses in one or more new store locations, resulting in higher operating expenses without a corresponding increase in revenues; the transaction costs and goodwill associated with acquisitions; the mix of products sold; pricing actions of competitors; the level of advertising and promotional expenses; and seasonality, primarily because the sales and profitability of our stores are typically slightly lower in the first and second quarters of the fiscal year than in other quarters. Most of our operating expenses, such as rent expense, advertising expense and employee salaries, do not vary directly with the amount of sales and are difficult to adjust in the short term. As a result, if sales in a particular quarter are below expectations for that quarter, we may not proportionately reduce operating expenses for that quarter, and therefore this sales shortfall would have a disproportionately negative effect on our net income for the quarter.

*If businesses we acquire do not perform as well as we expect or have liabilities that we are not aware of, we could suffer consequences that would substantially reduce our revenues, earnings and cash flows.* Our business strategy includes growth of our retail store channel, both through the development and opening of new Dover-branded store sites and the acquisition and conversion of existing retail stores to the Dover brand. Our financial performance may be adversely affected as the result of such acquisitions by such factors as: (1) difficulty in assimilating the acquired operations and employees, (2) inability to successfully integrate the acquired inventory and operations into our business and maintain uniform standards, controls, policies, and procedures; (3) lower-than-expected loyalty of the customer base of the acquired business to Dover-branded stores and products; (4) post-acquisition variations in the product mix offered by the stores of the acquired business, resulting in lower revenues and gross margins; and (5) declines in revenues of stores of the acquired business from historical levels and those projected. Further, businesses we acquire may have unknown or contingent liabilities that are in excess of the amounts that we have estimated. Although we have obtained indemnification, we may discover liabilities greater than the contractual limits or the financial resources of the indemnifying party. In the event that we are responsible for liabilities substantially in excess of any amounts recovered through rights to indemnification, we could suffer severe consequences that would substantially reduce our revenues, earnings and cash flows.

*The future sale of shares of our common stock may negatively impact our stock price.* If our shareholders sell substantial amounts of our common stock, the market price of our common stock could fall. A reduction in ownership by our controlling shareholders or any other large shareholders could cause the market price of our common stock to fall. Similarly, the market may disfavor the adoption of Rule 10b5-1 trading plans by one or more of the Company's Officers or Directors, perceiving that such a plan represents a decline in management's confidence about the Company's prospects or that the parameters for and trading under a Rule 10b5-1 sales plan could cause downward pressure on the stock price. In addition, the average daily trading volume in our stock is relatively low. The lack of trading activity in our stock may lead to greater fluctuations in our stock price. Low trading volume may also make it difficult for shareholders to make transactions in a timely fashion.

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### Item 2. Use of Proceeds from Registered Securities

The remaining proceeds from the initial public offering which were not utilized to pay down our subordinated debt and temporarily reduce our revolving loan balances totaled \$2.8 million as of December 31, 2005. In the first nine months of 2006, our cash management function utilized the remaining cash available from the Company portion of the offering for normal seasonal working capital needs of the business. As of the end of the third quarter of 2006, the proceeds of our offering remain available through our improved ability to draw on our senior credit facility for other purposes, including new store growth.

### Item 5. Other Information

Our policy governing transactions in our securities by directors, officers and employees permits our officers, directors and certain other persons to enter into trading plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended. Mr. Jonathan A.R. Grylls, our Chief Operating Officer and member of our Board of Directors, has entered into a trading plan (a "Plan") covering periods after the date of this Quarterly Report in accordance with Rule 10b5-1 and the restrictions in our policy governing transactions in our securities. Generally, under these trading plans, the individual relinquishes control over the transactions once the trading plan is put into place. Accordingly, sales under these plans may occur at any time, including possibly before, simultaneously with, or immediately after significant events involving our company.

We anticipate that, as permitted by Rule 10b5-1 and our policy governing transactions in our securities, some or all of our officers, directors and employees may establish trading plans in the future. We intend to disclose the names of executive officers and directors who establish a trading plan in compliance with Rule 10b5-1 and the requirements of our policy governing transactions in our securities in our future quarterly and annual reports on Form 10-Q and 10-K filed with the Securities and Exchange Commission. However, we undertake no obligation to update or revise the information provided herein, including for revision or termination of an established trading plan, other than in such quarterly and annual reports.

As disclosed in Note C to the Financial Statements in Part 1, Item 1, on October 26, 2006 (following the date of this report), the Company awarded 155,529 options to purchase shares of the Company's common stock to directors, officers, and key employees. Related future stock based compensation expense will be reflected in the consolidated financial statements beginning in the fourth quarter of 2006. This change will have the effect of decreasing our net income and earnings per share, which may negatively impact our stock price.

The Company's Board of Directors plans to increase the size of the Board to seven members, and the current independent directors plan, on or before November 16, 2006, to elect a seventh Director who, as a class II Director, meets the definition of independence as specified by NASDAQ and SEC rules and whom they have affirmatively determined has no relationships that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. In connection with such election, the Company plans to timely file a current report on Form 8-K with requisite information about such anticipated seventh Director.

In order to expedite the efficient build-out of leasehold improvements in its new retail stores, the Company utilizes the services of a real estate development firm owned by a Company employee and minority stockholder to source construction services and retail fixtures. As confirmed by the Audit Committee, the Company negotiated this arrangement on commercially fair and reasonable terms on an arms-length basis with the development firm's owner, who is not an officer or director of the Company. Total payments for the nine months ended September 30, 2006, consisting primarily of reimbursements for materials and outside labor, for the fit-up of five stores were \$283,000. Reimbursements in the prior fiscal year were \$91,000.

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**Item 6. Exhibits**

**EXHIBIT LIST**

<b>Number</b>	<b>Description</b>
*1.1	Form of Underwriting Agreement
*3.1	Amended and Restated Certificate of Incorporation of the Company
*3.2	Certificate of Amendment to Certificate of Incorporation of the Company
*3.3	Second Amended and Restated Certificate of Incorporation of the Company to be filed upon completion of this offering
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*3.5	Amended and Restated By-laws of the Company to be effective upon completion of this offering
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- ^32 .1 Certification by Chief Executive Officer and Chief Financial Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350
- \*99 .1 Consent of William F. Meagher, Jr.

---

^ Filed herewith

++ Filed with the Company's Quarterly Report on Form 10Q for the Fiscal Quarter Ending June 30, 2006, on August 14, 2006.

\* Incorporated by reference herein to the exhibits to the Company's Registration Statement on Form S-1 (File No. 333-127888)

\*\* Incorporated by reference to the exhibit to the Company's Registration Statement on Form S-8 on April 3, 2006

# Filed with the Company's Annual Report on Form 10-K for the Fiscal Year Ending December 31, 2005, on March 30, 2006

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## 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.

DOVER SADDLERY, INC.

Dated: November 13, 2006

By: /s/ Michael W. Bruns  
Michael W. Bruns, Chief Financial Officer  
(Principal Financial Officer and Duly Authorized Officer)

**DOVER SADDLERY, INC. AND SUBSIDIARIES**  
**FORM 10-Q**  
**FOR THE QUARTER ENDED SEPTEMBER 30, 2006**  
**EXHIBIT INDEX**

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### **FIRST AMENDMENT AND EXTENSION TO LEASE AGREEMENT — Exhibit 10.47**

This First Amendment and Extension to Lease Agreement dated this \_\_\_\_ day of September, 2006 by and between C.E. HOLMAN LIMITED PARTNERSHIP, having a mailing address of 40 Grove Street, Wellesley, Massachusetts 02181 (hereinafter referred to as the "Landlord"), and DOVER SADDLERY, INC., having a mailing address of 525 Great Road, PO Box 1100, Littleton, MA 01460 (hereinafter referred to as the "Tenant").

WHEREAS, on May 29, 1997, Landlord entered into a lease (the "Lease") with Tenant for premises located in a shopping area known as the Holman Block on Washington and Church Streets in the Town of Wellesley, County of Norfolk, Massachusetts, being more specifically designated as the two contiguous stores numbered 591 and 595 Washington Street comprising approximately 1,300 and 1,600 square feet, respectively on the first floors and two basements (hereinafter the "Premises"); and

WHEREAS, the Lease states that the term of the Lease shall be for a period of nine (9) years and ten (10) months, ending on the thirtieth (30<sup>th</sup>) day of June, 2007; and

WHEREAS, the Lease states that the Tenant shall have the opportunity to extend the term of the Lease for one (1) successive period of five (5) years; and

WHEREAS, the Tenant desires to extend the term of the Lease for an additional five (5) year period, commencing on July 1, 2007 and terminating on June 30, 2012; and

WHEREAS, Landlord acknowledges that Tenant has provided timely notice of its intention to extend the term of the Lease for an additional five (5) year period, commencing on July 1, 2007 and terminating on June 30, 2012.

NOW, THEREFORE, in consideration of the mutual covenants and conditions contained herein, the parties agree as follows:

1. Pursuant to the terms of the Lease, Tenant will rent the Premises from the Landlord for an extended term, commencing on July 1, 2007 and terminating on June 30, 2012.
2. Section XXIX of the Lease is deleted in its entirety and replaced as follows:

#### **"XXIX. EXTENSION"**

The Lease having been extended through June 30, 2012, the Tenant shall have the right, to be exercised as hereinafter provided, to extend the term of this Lease for one (1) additional period of five (5) years upon the following terms and conditions:

1. At the time of the exercise of such right, the Tenant shall not be in default in the performance of any of the terms, covenants, or conditions herein contained with respect to a matter as to which notice of default has been given hereunder and which has not been remedied within the time limited in this Lease and the Tenant must not have been in default in performance of any of the terms, covenants or conditions herein contained with respect to a matter as to which notice of default has been given hereunder on more than three (3) occasions regardless of whether said defaults were cured within the time allowed under this lease.
  2. Both extensions shall be upon the same terms, covenants, and conditions as in this Lease provided, except that,
    - a. There will be no further opportunity to extend the term of this Lease beyond June 30, 2017;
    - b. During the extension period beginning July 1, 2007 through June 30, 2012, the annual MINIMUM RENTAL rate payable by Tenant to Landlord shall be the fair market rental value of the premises. Said fair market rental value shall be determined as follows: Fair Market Rental shall be defined as the average per square foot rental for street level retail stores which have signed new leases within three months of December 31, 2006, in the Wellesley Shopping District. The Wellesley Shopping District shall be defined as the retail
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shopping area within Wellesley (not Wellesley Hills) on Washington Street and Church Street. Landlord shall, within thirty (30) days of December 31, 2006, inform Tenant of the annual MINIMUM RENTAL applicable to this extension period.

- c. During the extension period beginning July 1, 2012 through June 30, 2017, the annual MINIMUM RENTAL rate payable by Tenant to Landlord shall be the fair market rental value of the premises. Said fair market rental value shall be determined as follows: Fair Market Rental shall be defined as the average per square foot rental for street level retail stores which have signed new leases within three months of December 31, 2011, in the Wellesley Shopping District. The Wellesley Shopping District shall be defined as the retail shopping area within Wellesley (not Wellesley Hills) on Washington Street and Church Street. Landlord shall, within thirty (30) days of December 31, 2011, inform Tenant of the annual MINIMUM RENTAL applicable to this extension period.
  - d. If Tenant does not agree in either instance with the MINIMUM RENTAL within thirty (30) days of receipt of the notice of MINIMUM RENTAL from the Landlord, the fair market rental shall be a matter of arbitration, with each party bearing the cost of one arbitrator and splitting the cost of a third arbitrator chosen by the two arbitrators selected by the Landlord and Tenant. Arbitrators shall be persons professionally qualified to determine fair commercial rental value in the Town of Wellesley, having been active participants in the Wellesley real estate market for a minimum of five (5) years. Landlord and Tenant agree to be bound by either the agreed upon rent or the arbitrated rent.
3. The Tenant shall exercise its right to extend the term of the Lease for the extension period July 1, 2012 through June 30, 2017 by notifying the Landlord of the Tenant's election to exercise such right no later than October 1, 2011. Upon the giving of said notice, this Lease shall be deemed to be extended for the specified period, subject to the provisions of this article, without execution of any further instrument."

IN WITNESS WHEREOF, the parties hereto have executed this First Amendment and Extension to Lease Agreement on the day and year first written above.

LANDLORD:

C.E. HOLMAN LIMITED PARTNERSHIP

By: Steven H. Grindle, President of the Holman Corporation,

Dated: October 6, 2006

/s/ Steven H. Grindle

Its General Partner, duly authorized

TENANT:

DOVER SADDLERY, INC.

Dated: October 4, 2006

By: /s/ Stephen L. Day

Its President, duly authorized



**Exhibit 31.1**

**CERTIFICATION**

I, Stephen L. Day, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of DOVER SADDLERY, INC.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2006

\_\_\_\_\_  
/s/ Stephen L. Day  
Stephen L. Day  
President, Chief Executive Officer and  
Director  
(Principal Executive Officer)





**CERTIFICATION**

I, Michael W. Bruns, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of DOVER SADDLERY, INC.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2006

/s/ Michael W. Bruns  
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Michael W. Bruns  
Chief Financial Officer  
(Principal Financial Officer)



**Exhibit 32.1**

**CERTIFICATION**

In connection with the Quarterly Report on Form 10-Q of DOVER SADDLERY, INC. (the "Company") for the fiscal quarter ended September 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned officers certifies, to the best knowledge and belief of the signatory, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Stephen L. Day

Stephen L. Day  
President, Chief Executive Officer and  
Director  
*(Principal Executive Officer)*

Date: November 13, 2006

/s/ Michael W. Bruns

Michael W. Bruns  
Chief Financial Officer

*(Principal Financial Officer)*

Date: November 13, 2006