PRICESMART INC
Form 10-Q
January 07, 2016

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

FORM 10-Q

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

For the quarterly period ended November 30, 2015

OR

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

For the transition period from to

COMMISSION FILE NUMBER 0-22793

PriceSmart, Inc.

(Exact name of registrant as specified in its charter)

Delaware	33-0628530
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9740 Scranton Road, San Diego, CA 92121
(Address of principal executive offices)

(858) 404-8800
(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 ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ý No ¨

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

Large accelerated filer ý Accelerated filer ¨ Non-accelerated filer ¨ Smaller Reporting Company ¨

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

Yes ¨ No ý

The registrant had 30,371,982 shares of its common stock, par value $0.0001 per share, outstanding at December 31, 2015.

PRICESMART, INC.

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PriceSmart, Inc.’s (“PriceSmart,” "we" or the “Company”) unaudited consolidated balance sheet as of November 30, 2015 and the consolidated balance sheet as of August 31, 2015, the unaudited consolidated statements of income for the three months ended November 30, 2015 and 2014, the unaudited consolidated statements of comprehensive income for the three months ended November 30, 2015 and 2014, the unaudited consolidated statements of equity for the three months ended November 30, 2015 and 2014, and the unaudited consolidated statements of cash flows for the three months ended November 30, 2015 and 2014, are included herein. Also included herein are the notes to the unaudited consolidated financial statements.

PRICESMART, INC.
CONSOLIDATED BALANCE SHEETS
(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

	November 30, 2015 (Unaudited)	August 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$140,006	$157,072
Short-term restricted cash	60	61
Receivables, net of allowance for doubtful accounts of $0 as of November 30, 2015 and August 31, 2015, respectively	7,691	9,662
Merchandise inventories	322,623	267,175
Deferred tax assets – current	8,229	7,849
Prepaid expenses and other current assets	28,735	22,535
Total current assets	507,344	464,354
Long-term restricted cash	2,063	1,464
Property and equipment, net	443,062	433,040
Goodwill	35,846	35,871
Deferred tax assets – long term	7,016	7,464
Other non-current assets (includes $4,208 and $4,129 as of November 30, 2015 and August 31, 2015, respectively, for the fair value of derivative instruments)	41,881	39,182
Investment in unconsolidated affiliates	10,382	10,317
Total Assets	$1,047,594	$991,692
LIABILITIES AND EQUITY		
Current Liabilities:		
Short-term borrowings	$1,935	$6,606
Accounts payable	275,908	241,978
Accrued salaries and benefits	16,396	17,977
Deferred membership income	20,383	20,184
Income taxes payable	7,777	9,595
Other accrued expenses (includes $129 and $66 as of November 30, 2015 and August 31, 2015, respectively, for the fair value of foreign currency forward contracts)	23,450	23,558
Long-term debt, current portion	15,986	17,169
Deferred tax liability – current	18	30
Total current liabilities	361,853	337,097
Deferred tax liability – long-term	2,117	2,193
Long-term portion of deferred rent	7,264	6,595
Long-term income taxes payable, net of current portion	1,358	1,402
Long-term debt, net of current portion	78,437	73,365
Other long-term liabilities (includes $1,650 and $1,699 for the fair value of derivative instruments and $3,155 and $2,757 for post employment plans as of November 30, 2015 and August 31, 2015, respectively)	4,805	4,456
Total liabilities	455,834	425,108
Equity:		
Common stock, $0.0001 par value, 45,000,000 shares authorized; 31,164,162 and 30,977,764 shares issued and 30,370,982 and 30,184,584 shares outstanding (net of	3	3

treasury shares) as of November 30, 2015 and August 31, 2015, respectively		
Additional paid-in capital	405,268	403,168
Tax benefit from stock-based compensation	10,711	10,711
Accumulated other comprehensive loss	(102,108)	(101,512)
Retained earnings	307,283	283,611
Less: treasury stock at cost; 793,180 shares as of November 30, 2015 and August 31, 2015	(29,397)	(29,397)
Total equity	591,760	566,584
Total Liabilities and Equity	$1,047,594	$991,692

See accompanying notes.

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PRICESMART, INC.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED—AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

	Three Months Ended November 30,	
	2015	2014
Revenues:		
Net warehouse club sales	$690,831	$636,415
Export sales	8,232	8,431
Membership income	11,466	10,115
Other income	1,402	1,060
Total revenues	711,931	656,021
Operating expenses:		
Cost of goods sold:		
Net warehouse club	590,183	539,028
Export	7,832	8,027
Selling, general and administrative:		
Warehouse club operations	60,840	56,210
General and administrative	15,463	13,350
Pre-opening expenses	305	3,149
Loss/(gain) on disposal of assets	13	(28)
Total operating expenses	674,636	619,736
Operating income	37,295	36,285
Other income (expense):		
Interest income	178	264
Interest expense	(1,373)	(1,174)
Other income (expense), net	(244)	(2,632)
Total other income (expense)	(1,439)	(3,542)
Income before provision for income taxes and income (loss) of unconsolidated affiliates	35,856	32,743
Provision for income taxes	(12,130)	(12,102)
Income (loss) of unconsolidated affiliates	(54)	6
Net income	23,672	$20,647
Net income per share available for distribution:		
Basic net income per share	$0.78	$0.68
Diluted net income per share	$0.78	$0.68
Shares used in per share computations:		
Basic	29,890	29,791
Diluted	29,896	29,799
Dividends per share	$—	$—

See accompanying notes.

PRICESMART, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED—AMOUNTS IN THOUSANDS)

	Three Months Ended November 30,	
	2015	2014
Net income	$23,672	$20,647
Other Comprehensive Income, net of tax:		
Foreign currency translation adjustments [1]	$(472)	$(11,651)
Defined benefit pension plan:		
Net gain (loss) arising during period	(4)	(11)
Total defined benefit pension plan	(4)	(11)
Derivative instruments: [2]		
Unrealized gains/(losses) on change in fair value of interest rate swaps	(120)	2,243
Total derivative instruments	(120)	2,243
Other comprehensive income (loss)	(596)	(9,419)
Comprehensive income	$23,076	$11,228

(1) Translation adjustments arising in translating the financial statements of a foreign entity have no effect on the income taxes of that foreign entity. They may, however, affect: (a) the amount, measured in the parent entity's reporting currency, of withholding taxes assessed on dividends paid to the parent entity and (b) the amount of taxes assessed on the parent entity by the government of its country. The Company has determined that the reinvestment of earnings of its foreign subsidiaries are indefinite because of the long-term nature of the Company's foreign investment plans. Therefore, deferred taxes are not provided for on translation adjustments related to non-remitted earnings of the Company's foreign subsidiaries.

(2) See Note 9 - Derivative Instruments and Hedging Activities.

See accompanying notes.

PRICESMART, INC.
CONSOLIDATED STATEMENTS OF EQUITY
(UNAUDITED—AMOUNTS IN THOUSANDS)

	Common Stock		Additional Paid-in	Tax Benefit From Stock Based	Accumulated Other Compre-hensive	Retained	Treasury Stock		Total
	Shares	Amount	Capital	Compen-sation	Income(Loss)	Earnings	Shares	Amount	Equity
Balance at August 31, 2014	30,951	$ 3	$ 397,150	$ 9,505	$ (49,286)	$ 215,613	741	$ (24,720)	$ 548,265
Issuance of restricted stock award	—	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	1,556	—	—	—	—	—	1,556
Net income	—	—	—	—	—	20,647	—	—	20,647
Other comprehensive income (loss)	—	—	—	—	(9,419)	—	—	—	(9,419)
Balance at November 30, 2014	30,951	$ 3	$ 398,706	$ 9,505	$ (58,705)	$ 236,260	741	$ (24,720)	$ 561,049
Balance at August 31, 2015	30,978	$ 3	$ 403,168	$ 10,711	$ (101,512)	$ 283,611	793	$ (29,397)	$ 566,584
Issuance of restricted stock award	186	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	2,100	—	—	—	—	—	2,100
Net income	—	—	—	—	—	23,672	—	—	23,672
Other comprehensive income (loss)	—	—	—	—	(596)	—	—	—	(596)
Balance at November 30, 2015	31,164	$ 3	$ 405,268	$ 10,711	$ (102,108)	$ 307,283	793	$ (29,397)	$ 591,760

See accompanying notes.

PRICESMART, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED—AMOUNTS IN THOUSANDS)

	Three Months Ended November 30,	
	2015	2014
Operating Activities:		
Net income	$23,672	$20,647
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,203	7,797
(Gain)/loss on sale of property and equipment	13	(28)
Deferred income taxes	470	2,607
Equity in (gains) losses of unconsolidated affiliates	54	(6)
Stock-based compensation	2,100	1,556
Change in operating assets and liabilities:		
Receivables, prepaid expenses and other current assets, accrued salaries and benefits, deferred membership income and other accruals	(10,473)	(6,888)
Merchandise inventories	(55,448)	(97,025)
Accounts payable	32,291	57,474
Net cash provided by (used in) operating activities	1,882	(13,866)
Investing Activities:		
Additions to property and equipment	(17,708)	(26,332)
Deposits for land purchase option agreements	—	(2,023)
Proceeds from disposal of property and equipment	118	39
Investment in joint ventures	(119)	(1,200)
Net cash provided by (used in) investing activities	(17,709)	(29,516)
Financing Activities:		
Proceeds from long-term bank borrowings	7,370	18,350
Repayment of long-term bank borrowings	(3,345)	(10,625)
Proceeds from short-term bank borrowings	2,255	25,807
Repayment of short-term bank borrowings	(6,882)	(8,000)
Net cash provided by (used in) financing activities	(602)	25,532
Effect of exchange rate changes on cash and cash equivalents	(637)	(35)
Net increase (decrease) in cash and cash equivalents	(17,066)	(17,885)
Cash and cash equivalents at beginning of period	157,072	137,098
Cash and cash equivalents at end of period	$140,006	$119,213
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest, net of amounts capitalized	$1,325	$1,040
Income taxes	$12,236	$11,657

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
November 30, 2015

NOTE 1 – COMPANY OVERVIEW AND BASIS OF PRESENTATION

PriceSmart, Inc.'s ("PriceSmart" or the "Company") business consists primarily of international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. As of November 30, 2015, the Company had 38 consolidated warehouse clubs in operation in 12 countries and one U.S. territory (six in Costa Rica and Colombia; five in Panama; four in Trinidad; three in Guatemala, Honduras and the Dominican Republic; two in El Salvador and Nicaragua; and one each in Aruba, Barbados, Jamaica, and the United States Virgin Islands), of which the Company owns 100% of the corresponding legal entities (see Note 2 - Summary of Significant Accounting Policies). In January 2014, the Company acquired land in Pereira, Colombia and in the city of Medellin, Colombia and leased land in the city of Bogota, Colombia. The Company built new warehouse clubs at these three sites, and opened the Bogota location in October 2014 and opened the other two sites in November 2014. Together with the three warehouse clubs that were operating prior to these openings in Colombia (one in Barranquilla and two in Cali), these three new clubs brought the number of PriceSmart warehouse clubs operating in Colombia to six. In September 2014, the Company acquired land in La Chorrera ("Costa Verde"), west of Panama City, Panama, on which the Company opened its fifth PriceSmart warehouse club in Panama in June 2015. In April 2015, the Company acquired land in Managua, Nicaragua. The Company constructed and opened a warehouse club on this site in November 2015. The Company purchased land in Chia, a city north of Bogota, Colombia where it is currently constructing a new warehouse club that is expected to open in the fall of 2016. The Company continues to explore other potential sites for future warehouse clubs in Central America, the Caribbean and Colombia.

Basis of Presentation - The interim consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2015 (the "2015 Form 10-K"). The interim consolidated financial statements include the accounts of PriceSmart, Inc., a Delaware corporation, and its subsidiaries. Inter-company transactions between the Company and its subsidiaries have been eliminated in consolidation.

The Company has evaluated subsequent events through the date and time these financial statements were issued.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation – The interim consolidated financial statements of the Company included herein include the assets, liabilities and results of operations of the Company’s wholly owned subsidiaries and the Company's investment in, and the Company's share of the income (loss) of, joint ventures recorded under the equity method. All significant inter-company accounts and transactions have been eliminated in consolidation. The interim consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the SEC and reflect all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary to fairly present the financial position, results of operations, and cash flows for the periods presented. The results for interim periods are not necessarily indicative of the results for the full year. As of November 30, 2015, all of the Company's subsidiaries were wholly owned. Additionally, the Company's ownership interest in real estate development joint ventures as of November 30, 2015 is listed below:

Real Estate Development Joint Ventures	Countries	Ownership		Basis of Presentation
GolfPark Plaza, S.A.	Panama	50.0	%	Equity[1]
Price Plaza Alajuela PPA, S.A.	Costa Rica	50.0	%	Equity[1]

(1) Joint venture interests are recorded as investment in unconsolidated affiliates on the consolidated balance sheets.

Use of Estimates – The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Variable Interest Entities – The Company reviews and determines at the start of each arrangement, or subsequently if a reconsideration event occurs, whether any of its investments in joint ventures are a Variable Interest Entity (“VIE”) and whether it must consolidate a VIE and/or disclose information about its involvement in a VIE. The Company has determined that the joint ventures for GolfPark Plaza (Panama) and Price Plaza Alajuela (Costa Rica) are VIEs. The Company has determined that it is not the primary beneficiary of the VIEs and, therefore, has accounted for these entities under the equity method.

Cash and Cash Equivalents – Cash and cash equivalents represent cash and short-term investments with maturities of three months or less when purchased and proceeds due from credit and debit card transactions, which are generally settled within a few days of the underlying transaction.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Restricted Cash – The changes in restricted cash are disclosed within the consolidated statement of cash flows based on the nature of the restriction. The following table summarizes the restricted cash reported by the Company (in thousands):

	November 30, 2015	August 31, 2015
Short-term restricted cash:		
Other short-term restricted cash [(1)]	$60	$61
Total short-term restricted cash	$60	$61
Long-term restricted cash:		
Other long-term restricted cash [(1)]	$2,063	$1,464
Total long-term restricted cash	$2,063	$1,464
Total restricted cash	$2,123	$1,525

(1) Other short-term and long-term restricted cash consists mainly of cash deposits held within banking institutions in compliance with federal regulatory requirements in Costa Rica and Panama.

Tax Receivables - The Company pays Value Added Tax (“VAT”) or similar taxes (“input VAT”), income taxes, and other taxes within the normal course of its business in most of the countries in which it operates related to the procurement of merchandise and/or services it acquires and/or on sales and taxable income. The Company also collects VAT or similar taxes on behalf of the government (“output VAT”) for merchandise and/or services it sells. If the output VAT exceeds the input VAT, then the difference is remitted to the government, usually on a monthly basis. If the input VAT exceeds the output VAT, this creates a VAT receivable. In some countries where the Company operates, the governments have implemented additional collection procedures, such as requiring credit card processors to remit a portion of sales processed via credit card directly to the government as advance payments of VAT and/or income tax. In the case of VAT, these procedures alter the natural offset of input and output VAT and generally leave the Company with a net VAT receivable, forcing the Company to process significant refund claims on a recurring basis.

With respect to income taxes paid, if the estimated income taxes paid or withheld exceed the actual income tax due, this creates an income tax receivable. The Company either requests a refund of these tax receivables or applies the balance to expected future tax payments. These refund or offset processes can take anywhere from several months to several years to complete.

In most countries where the Company operates, the tax refund process is defined and structured with regular refunds or offsets. However, in two countries the governments have alleged that there is no defined process in the law to allow them to refund VAT receivables. The Company, together with its tax and legal advisers, is currently appealing these interpretations in court and expects to prevail. In one of these countries, where there is recent favorable jurisprudence, the government performed an audit to verify the amount of the respective VAT receivables as a required precursor to any refund. The balance of the VAT receivable in these countries was $6.9 million and $6.5 million as of November 30, 2015 and August 31, 2015, respectively. In another country in which the Company has warehouse clubs, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires the Company to pay taxes based on a percentage of sales rather than income. As a result, the Company is making income tax payments substantially in excess of those it would expect to pay based on taxable income. The current rules (which the Company has challenged in court) do not clearly allow the Company to obtain a refund or offset this excess income tax against other taxes. As of November 30, 2015, the Company had deferred tax assets of approximately $1.6 million in this country. Also, the Company had an income tax receivable balance of $1.7 million as of November 30, 2015 related to excess payments from fiscal year 2015. The Company has not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets, because the Company believes that it is more likely than not that it will succeed in its refund request and/or court challenge on this matter.

The Company's policy for classification and presentation of VAT receivables, income tax receivables and other tax receivables is as follows:

•Short-term VAT and Income tax receivables, recorded as Other current assets: This classification is used for any

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

countries where the Company's subsidiary has generally demonstrated the ability to recover the VAT or income tax receivable within one year. The Company also classifies as short-term any approved refunds or credit notes to the extent that the Company expects to receive the refund or use the credit notes within one year.

•Long-term VAT and Income tax receivables, recorded as Other non-current assets: This classification is used for amounts not approved for refund or credit in countries where the Company's subsidiary has not demonstrated the ability to obtain refunds within one year and/or for amounts which are subject to outstanding disputes. An allowance is provided against VAT and income tax receivable balances in dispute when the Company does not expect to eventually prevail in its recovery.

The following table summarizes the VAT receivables reported by the Company (in thousands):

	November 30, 2015	August 31, 2015
Prepaid expenses and other current assets	$9,004	$4,673
Other non-current assets	24,428	22,239
Total amount of VAT receivable reported	$33,432	$26,912

The following table summarizes the Income tax receivables reported by the Company (in thousands):

	November 30, 2015	August 31, 2015
Prepaid expenses and other current assets	$2,765	$2,941
Other non-current assets	9,178	8,772
Total amount of income tax receivable reported	$11,943	$11,713

Lease Accounting – Certain of the Company's operating leases where the Company is the lessee (see Revenue Recognition Policy for lessor accounting) provide for minimum annual payments that increase over the expected life of the lease. The aggregate minimum annual payments are expensed on the straight-line basis beginning when the Company takes possession of the property and extending over the expected term of the related lease including renewal options when the exercise of the option is reasonably assured as an economic penalty may be incurred if the option is not exercised. The amount by which straight-line rent exceeds actual lease payment requirements in the early years of the leases is accrued as deferred rent and reduced in later years when the actual cash payment requirements exceed the straight-line expense. The Company also accounts in its straight-line computation for the effect of any “rental holidays” and lessor-paid tenant improvements. In addition to the minimum annual payments, in certain locations, the Company pays additional contingent rent based on a contractually stipulated percentage of sales.

Merchandise Inventories - Merchandise inventories, which include merchandise for resale, are valued at the lower of cost (average cost) or market. The Company provides for estimated inventory losses and obsolescence between physical inventory counts on the basis of a percentage of sales. The provision is adjusted periodically to reflect the trend of actual physical inventory count results, with physical inventories occurring primarily in the second and fourth fiscal quarters. In addition, the Company may be required to take markdowns below the carrying cost of certain inventory to expedite the sale of such merchandise.

Fair Value Measurements – The Company measures the fair value for all financial and nonfinancial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements on a recurring or nonrecurring basis. The fair value of an asset is the price at which the asset could be sold in an orderly transaction between unrelated, knowledgeable and willing parties able to engage in the transaction. A liability's fair value is defined as the amount that would be paid to transfer the liability to a new obliger in a transaction between such parties, not the amount that would be paid to settle the liability with the creditor.

The Company has established a three-tier fair value hierarchy, which prioritizes the inputs used in measuring and revaluing fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. The Company was not required to revalue any assets or liabilities utilizing Level 1 or Level 3 inputs at the balance sheet dates. The Company's Level 2 assets and liabilities revalued at the balance sheet dates, on a recurring basis, primarily included cash flow hedges (interest rate swaps and cross-currency interest rate swaps) and forward foreign exchange contracts. In addition, the Company utilizes Level 2 inputs in determining the fair value of long-term debt. The Company has elected not to revalue long-term debt because this debt will be settled at the carrying value and not at the fair market value. The Company did not make any significant transfers in and out of Level 1 and Level 2 fair value tiers during the periods reported on herein.

Non-financial assets and liabilities are revalued and recognized at fair value subsequent to initial recognition when there is evidence of impairment. For the periods reported, no impairment of such non-financial assets was recorded.

The disclosure of fair value of certain financial assets and liabilities recorded at cost is as follows:

Cash and cash equivalents: The carrying value approximates fair value due to the short maturity of these instruments.

Short-term restricted cash: The carrying value approximates fair value due to the short maturity of these instruments.

Long-term restricted cash: Long-term restricted cash primarily consists of auto renewable 3-12 month certificates of deposit, which are held as collateral against our long-term debt. The carrying value approximates fair value due to the maturity of the underlying certificates of deposit within the normal operating cycle of the Company.

Accounts receivable: The carrying value approximates fair value due to the short maturity of these accounts.

Short-term VAT and Income tax receivables: The carrying value approximates fair value due to the short maturity of these accounts.

Long-term VAT and Income tax receivables: The fair value of long-term receivables would normally be measured using a discounted cash flow analysis based on the current market interest rates for similar types of financial instruments, with an estimate of the time these receivables are expected to be outstanding. However, the Company is not able to provide an estimate on the time these receivables owed to the Company by various government agencies are expected to be outstanding; therefore, the Company has not presented a fair value on the long-term VAT and Income tax receivables.

Short-term debt: The carrying value approximates fair value due to the short maturity of these instruments.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Long-term debt: The fair value of debt is generally measured using a discounted cash flow analysis based on current market interest rates for similar types of financial instruments. These inputs are not quoted prices in active markets but they are either directly or indirectly observable; therefore, they are classified as Level 2 inputs. The carrying value and fair value of the Company's debt as of November 30, 2015 and August 31, 2015 is as follows (in thousands):

	November 30, 2015		August 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt, including current portion	$94,423	$92,372	$90,534	$88,307

(1) The Company has disclosed the fair value of long-term debt, including debt for which it has entered into cross-currency interest rate swaps, using the derivative obligation as of November 30, 2015 and August 31, 2015, to estimate the fair value of long-term debt, which includes the effects that the cross-currency interest rate swaps have had on the fair value of long-term debt.

Derivatives Instruments and Hedging Activities - The Company uses derivative financial instruments for hedging and non-trading purposes to manage its exposure to changes in interest and currency exchange rates. In using derivative financial instruments for the purpose of hedging the Company's exposure to interest and currency exchange rate risks, the contractual terms of a hedged instrument closely mirror those of the hedged item, providing a high degree of risk reduction and correlation. Contracts that are effective at meeting the risk reduction and correlation criteria (effective hedge) are recorded using hedge accounting. If a derivative financial instrument is an effective hedge, changes in the fair value of the instrument will be offset in accumulated other comprehensive income (loss) until the hedged item completes its contractual term. If any portion of the hedge is deemed ineffective, the change in fair value of the hedged assets or liabilities will be immediately recognized in earnings during the period. Instruments that do not meet the criteria for hedge accounting, or contracts for which the Company has not elected hedge accounting, are valued at fair value with unrealized gains or losses reported in earnings during the period of the change. Valuation techniques utilized in the fair value measurement of assets and liabilities presented on the Company's consolidated balance sheets were not changed from previous practice during the reporting period. The Company seeks to manage counterparty risk associated with these contracts by limiting transactions to counterparties with which the Company has an established banking relationship. There can be no assurance, however, that this practice effectively mitigates counterparty risk.

Cash Flow Instruments. The Company is a party to receive floating interest rate, pay fixed-rate interest rate swaps to hedge the interest rate risk of certain U.S. dollar denominated debt within its international subsidiaries. The swaps are designated as cash flow hedges of interest expense risk. These instruments are considered effective hedges and are recorded using hedge accounting. The Company is also a party to receive variable interest rate, pay fixed interest rate cross-currency interest rate swaps to hedge the interest rate and currency exposure associated with the expected payments of principal and interest of U.S. denominated debt within its international subsidiaries whose functional currency is other than the U.S dollar. The swaps are designated as cash flow hedges of the currency risk related to payments on the U.S. denominated debt. These instruments are also considered to be effective hedges and are recorded using hedge accounting. Under cash flow hedging, the effective portion of the fair value of the derivative, calculated as the net present value of the future cash flows, is deferred on the consolidated balance sheets in accumulated other comprehensive loss. If any portion of an interest rate swap is determined to be an ineffective hedge, the gains or losses from changes in fair value would be recorded directly in the consolidated statements of income.

Amounts recorded in accumulated other comprehensive loss are released to earnings in the same period that the hedged transaction impacts consolidated earnings. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of interest rate swaps and cross-currency interest rate swaps as of November 30, 2015 and August 31, 2015.

Fair Value Instruments. The Company is exposed to foreign-currency exchange rate fluctuations in the normal course of business. The Company is also exposed to foreign-currency exchange rate fluctuations on U.S. dollar denominated liabilities within its international subsidiaries whose functional currency is other than the U.S. dollar. The Company manages these fluctuations, in part, through the use of non-deliverable forward foreign-exchange contracts that are intended to offset changes in cash flow attributable to currency exchange movements. The contracts are intended primarily to economically address exposure to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries whose functional currency is other than the U.S. dollar. Currently, these contracts are treated for accounting purposes as fair value instruments and do not qualify for derivative hedge accounting, and as such the Company does not apply derivative hedge accounting to record these

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transactions. As a result, these contracts are valued at fair value with unrealized gains or losses reported in earnings during the period of the change. The Company seeks to mitigate foreign-currency exchange-rate risk with the use of these contracts and does not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features and are limited to less than one year in duration. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of open, unsettled forward foreign-exchange contracts as of November 30, 2015 and August 31, 2015.

Early Settlement of Derivative Instruments Qualifying for Hedge Accounting. During the fourth quarter of fiscal year 2015, the Company's Colombia subsidiary paid off the outstanding principal balance of U.S. $24.0 million on loan agreements that were entered into by the subsidiary with Scotiabank & Trust (Cayman) Ltd before the scheduled loan payment dates. The Company's Colombia subsidiary also settled the cross-currency interest rate swaps that it had entered into with the Bank of Nova Scotia ("Scotia Bank") related to these loans during the fourth quarter of fiscal year 2015. As indicated above, for a derivative instrument to qualify for cash flow hedge accounting there must be an expectation that the derivative instrument will be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. As part of the determination that a derivative instrument is highly effective at offsetting the exposure, the Company must determine that that the forecasted transaction will occur; therefore, an entity's past ability to accurately predict forecasted transactions should be considered when determining if a hedged transaction qualifies for cash flow hedge accounting. To the extent an entity has developed a pattern of changing the probability of occurrence of forecasted transactions, the ability of the entity to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions would be called into question. The Company believes that the settlements of these derivatives does not demonstrate such a pattern and does not disqualify the Company from the application of hedge accounting for the remaining hedging instruments and underlying loans whose terms and conditions remain unchanged. The Company classifies cash payments or proceeds from termination of derivatives as net cash provided by (used in) operating activities within the consolidated statements of cash flows.

The following tables summarize financial assets and liabilities measured and recorded at fair value on a recurring basis in the Company’s consolidated balance sheet as of November 30, 2015 and August 31, 2015 (in thousands) for derivatives that qualify for hedge accounting:

Assets and Liabilities as of November 30, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other non-current assets - (Cross-currency interest rate swaps)	$—	$4,208	$—	$4,208
Other long-term liabilities – (Interest rate swaps)	—	(379)	—	(379)
Other long-term liabilities – (Cross-currency interest rate swaps)	—	(1,271)	—	(1,271)
Total	$—	$2,558	$—	$2,558

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Assets and Liabilities as of August 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other non-current assets - (Cross-currency interest rate swaps)	$—	$4,129	$—	$4,129
Other long-term liabilities – (Interest rate swaps)	—	(387)	—	(387)
Other long-term liabilities – (Cross-currency interest rate swaps)	—	(1,312)	—	(1,312)
Total	$—	$2,430	$—	$2,430

The following tables summarize financial assets and liabilities measured and recorded at fair value on a recurring basis in the Company's consolidated balance sheet as of November 30, 2015 and August 31, 2015 (in thousands) for derivatives that do not qualify for hedge accounting:

Assets and Liabilities as of November 30, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other accrued expenses (Foreign currency forward contracts)	$—	$(129)	$—	$(129)
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting	$—	$(129)	$—	$(129)

Assets and Liabilities as of August 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other accrued expenses (Foreign currency forward contracts)	$—	$(66)	$—	$(66)
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting	$—	$(66)	$—	$(66)

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Goodwill – The table below presents goodwill resulting from certain business combinations as of November 30, 2015 and August 31, 2015 (in thousands). The change in goodwill is a result of foreign exchange translation losses.

	November 30, 2015	August 31, 2015	Change
Goodwill	$35,846	$35,871	$(25)

The Company reviews goodwill at the entity level for impairment. The Company first reviews qualitative factors for each reporting unit, in determining if an annual goodwill test is required. If the Company's review of qualitative factors indicates a requirement for a test of goodwill impairment, the Company then will assess whether the carrying amount of a reporting unit is greater than zero and exceeds its fair value established during the Company's prior test of goodwill impairment ("established fair value"). If the carrying amount of a reporting unit at the entity level is greater than zero and its established fair value exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If either the carrying amount of the reporting unit is not greater than zero or if the carrying amount of the entity exceeds its established fair value, the Company performs a second test to determine whether goodwill has been impaired and to calculate the amount of that impairment.

Revenue Recognition – The Company recognizes merchandise sales revenue when title passes to the customer. For e-commerce sales, revenue is recognized upon pickup of the merchandise by the member or when the common carrier takes possession of the merchandise. Membership income represents annual membership fees paid by the Company’s warehouse club members, which are recognized ratably over the 12-month term of the membership. Membership refunds are prorated based on the remaining term of the membership; accordingly, no refund reserve is required to be established for the periods presented. The Company recognizes and presents revenue-producing transactions on a net of value added/sales tax basis.

The Company began offering Platinum memberships in Costa Rica during fiscal year 2013, which provides members with a 2% rebate on most items, up to an annual maximum of $500.00. Platinum members can apply this rebate to future purchases at the warehouse club at the end of the annual membership period. The Company records this 2% rebate as a reduction of revenue at the time of the sales transaction. Accordingly, the Company has reduced warehouse sales and has accrued a liability within other accrued expenses. The rebate is issued annually to Platinum members on March 1 and expires August 31. Any rebate amount not redeemed by August 31 is recognized as breakage revenue. The Company periodically reviews expired unused rebates outstanding, and the expired unused rebates are recognized as Revenues: Other income on the consolidated statements of income. The Company has determined that breakage revenue is insignificant; therefore, it records 100% of the Platinum membership liability at the time of sale, rather than estimating breakage.

The Company recognizes gift certificate sales revenue when the certificates are redeemed. The outstanding gift certificates are reflected as other accrued expenses in the consolidated balance sheets. These gift certificates generally have a one-year stated expiration date from the date of issuance. However, the absence of a large volume of transactions for gift certificates impairs the Company's ability to make a reasonable estimate of the redemption levels for gift certificates. Therefore, the Company assumes a 100% redemption rate that is the equivalent of no breakage prior to expiration of the gift certificate. The Company periodically reviews unredeemed outstanding gift certificates, and the gift certificates that have expired are recognized as Revenues: Other income on the consolidated statements of income.

Operating leases, where the Company is the lessor, with lease payments that have fixed and determinable rent increases are recognized as revenue on a straight-line basis over the expected lease term. The Company also accounts in its straight-line computation for the effect of any "rental holidays." Contingent rental revenue is recognized as the contingent rent becomes due per the individual lease agreements.

Insurance Reimbursements- Receipts from insurance reimbursements up to the amount of the losses recognized are considered recoveries. These recoveries are accounted for when they are probable of receipt. Insurance recoveries are not recognized prior to the recognition of the related cost. Anticipated proceeds in excess of the amount of loss recognized are considered gains and are subject to gain contingency guidance. Anticipated proceeds in excess of a loss recognized in the financial statements are not recognized until all contingencies related to the insurance claim are resolved.

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The Company’s Guatemala Pradera warehouse club experienced a fire in its merchandise receiving department during the early morning hours of June 4, 2015. No members or employees were in the warehouse club at the time. The fire was extinguished, but caused considerable smoke and some fire damage. The warehouse club was closed for nine days and reopened on June 13, 2015. The Company is insured for these costs and has filed an insurance claim with its insurance provider. During the quarter ended August 31, 2015, the Company recorded an initial receivable of approximately $2.8 million against the expected insurance payment related to expenses associated with the write off of inventory, equipment disposals, building repairs, other associated costs recognized related to the fire and for current replacement costs for assets lost in the fire in excess of the net book value (disposal cost). The Company received as of August 31, 2015 approximately $300,000 in payments against the claim filed and the receivable recorded. Of this amount, approximately $76,000 was recorded as a gain on disposal of assets, as proceeds received from the insurance reimbursement were in excess of the amount of loss recognized on the disposal of assets. Additionally, the Company recorded approximately $28,000 for the disposal of assets damaged during the fire, for which it had not yet been reimbursed. As of August 31, 2015, the Company's receivable related to this insurance claim was approximately $2.6 million. The Company’s insurance policy also addresses coverage for business interruption. During the fourth quarter of fiscal year 2015, the Company filed a claim with its insurance carrier for approximately $332,000 related to business interruption for which the Company did not record a receivable. Insurance proceeds for reimbursements related to business interruptions are considered gain contingencies and will not be recognized in the financial statements until the period in which all contingencies are resolved and the gain is realized. During the fourth quarter of fiscal year 2015, the Company expensed to cost of goods sold, net warehouse club expense of approximately $165,000 related to the write off of inventory not covered by insurance. Additionally, the Company expensed to selling, general and administrative approximately $34,000 in salaries related to the clean up and preparation of the warehouse club for reopening.

The Company received the final insurance settlement payments of approximately $3.1 million during the quarter ended November 30, 2015. As a result, the Company recorded a credit to cost of goods sold of approximately $165,000 during the period that reflects the reversal of the inventory written off previously and now covered under the claim and gain on the disposal of assets for $85,000 that included reimbursement from the insurance for assets disposed of in fiscal year 2015. Additionally, the Company recorded during the quarter other income from insurance proceeds of approximately $202,000 during the period that reflects the amount reimbursed to the Company for business interruption coverage, net of taxes and other miscellaneous amounts charged to the Company by the insurance company for storage of the damaged inventory.

Cost of Goods Sold – The Company includes the cost of merchandise, food service and bakery raw materials in cost of goods sold. The Company also includes in cost of goods sold the external and internal distribution and handling costs for supplying merchandise, raw materials and supplies to the warehouse clubs. External costs include inbound freight, duties, drayage, fees, insurance, and non-recoverable value-added tax related to inventory shrink, spoilage and damage. Internal costs include payroll and related costs, utilities, consumable supplies, repair and maintenance, rent expense, building and equipment depreciation at its distribution facilities and payroll and other direct costs for in-store demonstrations.

Vendor consideration consists primarily of volume rebates, time-limited product promotions, slotting fees, demonstration reimbursements and prompt payment discounts. Volume rebates that are not threshold-based are incorporated into the unit cost of merchandise reducing the inventory cost and cost of goods sold. Volume rebates that are threshold-based are recorded as a reduction to cost of goods sold when the Company achieves established purchase levels that are confirmed by the vendor in writing or upon receipt of funds. On a quarterly basis, the Company calculates the amount of rebates recorded in cost of goods sold that relates to inventory on hand and this amount is reclassified as a reduction to inventory. Product promotions are generally linked to coupons that provide for reimbursement to the Company from vendor rebates for the product being promoted. Slotting fees are related to consideration received by the Company from vendors for preferential "end cap" placement of the vendor's products within the warehouse club. Demonstration reimbursements are related to consideration received by the Company from vendors for the in-store promotion of the vendors' products. The Company records the reduction in cost of goods sold on a transactional basis for these programs. Prompt payment discounts are taken in substantially all cases, and therefore, are applied directly to reduce the acquisition cost of the related inventory, with the resulting effect recorded to cost of goods sold when the inventory is sold.

Selling, General and Administrative – Selling, general and administrative costs are comprised primarily of expenses associated with warehouse club operations. Warehouse club operations include the operating costs of the Company's warehouse clubs, including all payroll and related costs, utilities, consumable supplies, repair and maintenance, rent expense, building and equipment depreciation, and bank and credit card processing fees. Also included in selling, general and administrative expenses are the payroll and related costs for the Company's U.S. and regional purchasing and management centers.

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Pre-Opening Costs – The Company expenses pre-opening costs (the costs of start-up activities, including organization costs and rent) as incurred.

Asset Impairment Costs – The Company periodically evaluates its long-lived assets for indicators of impairment. Management's judgments are based on market and operational conditions at the time of the evaluation and can include management's best estimate of future business activity. These periodic evaluations could cause management to conclude that impairment factors exist, requiring an adjustment of these assets to their then-current fair value. Future business conditions and/or activity could differ materially from the projections made by management causing the need for additional impairment charges.

Contingencies and Litigation – The Company records and reserves for loss contingencies if (a) information available prior to issuance of the consolidated financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the consolidated financial statements and (b) the amount of loss can be reasonably estimated. If one or both criteria for accrual are not met, but there is at least a reasonable possibility that a loss will occur, the Company does not record a reserve for a loss contingency but describes the contingency within a note and provides detail, when possible, of the estimated potential loss or range of loss. If an estimate cannot be made, a statement to that effect is made.

Foreign Currency Translation – The assets and liabilities of the Company’s foreign operations are translated to U.S. dollars when the functional currency in the Company’s international subsidiaries is the local currency and not U.S. dollars. Assets and liabilities of these foreign subsidiaries are translated to U.S. dollars at the exchange rate on the balance sheet date, and revenue, costs and expenses are translated at average rates of exchange in effect during the period. The corresponding translation gains and losses are recorded as a component of accumulated other comprehensive income or loss. These adjustments will affect net income upon the sale or liquidation of the underlying investment. Monetary assets and liabilities denominated in currencies other than the functional currency of the respective entity (primarily U.S. dollars) are revalued to the functional currency using the exchange rate on the balance sheet date. These foreign exchange transaction gains (losses), including transactions recorded involving these monetary assets and liabilities, are recorded as Other income (expense) in the consolidated statements of income.

The following table summarizes the amounts recorded for the three month periods ending November 30, 2015 and 2014 (in thousands):

	Three Months Ended	
	November 30, 2015	November 30, 2014
Currency gain (loss)	$ (244)	$ (2,632)

Income Taxes –The Company accounts for income taxes using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and carry-forwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established when necessary to reduce deferred tax assets to amounts expected to be realized.

The Company and its subsidiaries are required to file federal and state income tax returns in the United States and various other tax returns in foreign jurisdictions. The preparation of these tax returns requires the Company to interpret the applicable tax laws and regulations in effect in such jurisdictions, which could affect the amount of tax paid by the Company. The Company, in consultation with its tax advisors, bases its tax returns on interpretations that are believed to be reasonable under the circumstances. The tax returns, however, are subject to routine reviews by the various federal, state and foreign taxing authorities in the jurisdictions in which the Company or one of its subsidiaries files tax returns. As part of these reviews, a taxing authority may disagree with respect to the income tax positions taken by the Company ("uncertain tax positions") and, therefore, require the Company or one of its subsidiaries to pay additional taxes.

The Company accrues an amount for its estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than

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50% likelihood of being sustained. This requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. When facts and circumstances change, the Company reassesses these probabilities and records any changes in the consolidated financial statements as appropriate. There were no material changes in the Company's uncertain income tax positions as of November 30, 2015 and August 31, 2015. During the first quarter of fiscal year 2015, one of the Company’s subsidiaries received provisional assessments claiming $2.6 million of taxes, penalties and interest related to withholding taxes on certain charges for services rendered by the Company. In addition, this subsidiary received provisional assessments totaling $5.2 million for lack of deductibility of the underlying service charges due to the lack of withholding. Based on a review of the Company's tax advisers' interpretation of local law, rulings and jurisprudence (including supreme court precedents with respect to the deductibility assessment), the Company expects to prevail in both instances and has not recorded a provision for these assessments. Also, in another country, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires the Company to pay taxes based on a percentage of sales rather than income. As a result, the Company is making income tax payments substantially in excess of those it would expect to pay based on taxable income. The current rules (which the Company has challenged in court) do not clearly allow the Company to obtain a refund or offset this excess income tax against other taxes. As of November 30, 2015, the Company had deferred tax assets of approximately $1.6 million in this country. Also, the Company had an income tax receivable balance of $1.7 million as of November 30, 2015 related to excess payments from fiscal year 2015. The Company has not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets, because the Company believes that it is more likely than not that it will succeed in its refund request and/or court challenge on this matter.

The Company has not provided for U.S. deferred taxes on cumulative non-U.S. undistributed earnings as such earnings are deemed by the Company to be indefinitely reinvested. It is not practicable to determine the U.S. federal income tax liability that would be associated with such earnings because of the complexity of the computation.

The following tables present a reconciliation of the effective tax rate for the periods presented:

	Three Months Ended			
	November 30, 2015		November 30, 2014	
Federal tax provision at statutory rates	35.0	%	35.0	%
State taxes, net of federal benefit	0.4		0.5	
Differences in foreign tax rates	(4.7	)	(4.6	)
Permanent items and other adjustments	2.0		3.2	
Increase (decrease) in foreign valuation allowance	1.1		2.9	
Provision for income taxes	33.8	%	37.0	%

The variance in the effective tax rate for the three-month period ended on November 30, 2015 compared to the same period of the prior year was primarily attributable to the favorable impact of 3.25% resulting from the net effect of a decreased taxable loss incurred in the Company’s Colombia subsidiary for which no tax benefit was recognized net of adjustment to valuation allowance offset by the unfavorable impact of 0.53% resulting from a retroactive change in the statutory income tax rate in one of the foreign jurisdictions.

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Recent Accounting Pronouncements

FASB ASC 740 ASU 2015-17 -Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes

In November 2015, the Financial Accounting Standards Board ("FASB") issued amendments to the guidance that eliminates the current requirement for organizations to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, organizations will be required to classify all deferred tax assets and liabilities as noncurrent.

The amendment in this ASU is effective on a prospective or retrospective basis for public entities for fiscal years and interim periods within those annual periods beginning after December 15, 2016. Early adoption is allowed. The Company is currently reviewing the adoption of this amendment to the guidance. Upon adoption, the Company will be required to classify all deferred tax assets and liabilities as noncurrent.

FASB ASC 330 ASU 2015-11 -Inventory (Topic 330): Simplifying the Measurement of Inventory

In July 2015, the FASB issued guidance that will require an entity to measure in scope inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. This amendment applies to entities that measure inventory value using the average cost method. The amendments in this Update more closely align the measurement of inventory in GAAP with the measurement of inventory in International Financial Reporting Standards.

The amendment in this ASU is effective on a prospective basis for public entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early application is permitted as of the beginning of an interim or annual reporting period. Adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

FASB ASC 350 ASU 2015-05 - Customers accounting for fees paid in a cloud computing arrangement

In April 2015, the FASB issued amended guidance on about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments do not change the accounting for a customer’s accounting for service contracts.

The amendments in this ASU are effective for public entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity can elect to adopt the amendments either: (1) prospectively to all arrangements entered into or materially modified after the effective date; or (2) retrospectively. Adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

FASB ASC 606 ASU 2014-09 - Revenue from contracts with customers.

In May 2014, the FASB issued amended guidance on contracts with customers to transfer goods or services or contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). The guidance requires an entity to recognize revenue on contracts with customers relating to the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance requires that an entity depict the consideration by applying the following steps:

Step 1: Identify the contract(s) with a customer.
Step 2: Identify the performance obligations in the contract.
Step 3: Determine the transaction price.
Step 4: Allocate the transaction price to the performance obligations in the contract.
Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

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The amendments in this ASU were deferred by ASU 2015-14 for all entities by one year and is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. This amendment is to be either retrospectively adopted to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this ASU recognized at the date of initial application. Management is evaluating the impact adoption of this guidance may have on the Company's consolidated financial statements.

NOTE 3 – PROPERTY AND EQUIPMENT

Property and equipment are stated at historical cost. The historical cost of acquiring an asset includes the costs incurred to bring it to the condition and location necessary for its intended use. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets. The useful life of fixtures and equipment ranges from three to 15 years and that of certain components of building improvements and buildings from 10 to 25 years. Leasehold improvements are amortized over the shorter of the life of the improvement or the expected term of the lease. In some locations, leasehold improvements are amortized over a period longer than the initial lease term where management believes it is reasonably assured that the renewal option in the underlying lease will be exercised as an economic penalty may be incurred if the option is not exercised. The sale or purchase of property and equipment is recognized upon legal transfer of property. For property and equipment sales, if any long-term notes are carried by the Company as part of the sales terms, the sale is reflected at the net present value of current and future cash streams.

Property and equipment consist of the following (in thousands):

	November 30, 2015	August 31, 2015
Land	$ 128,924	$ 128,071
Building and improvements	289,517	278,982
Fixtures and equipment	174,404	164,916
Construction in progress	23,953	26,679
Total property and equipment, historical cost	616,798	598,648
Less: accumulated depreciation	(173,736)	(165,608)
Property and equipment, net	$ 443,062	$ 433,040

Depreciation and amortization expense (in thousands):

	Three Months Ended November 30,	
	2015	2014
Depreciation and amortization expense	$ 9,203	$ 7,797

The Company capitalizes interest on expenditures for qualifying assets over a period that covers the duration of the activities required to get the asset ready for its intended use, provided that expenditures for the asset have been made and interest cost is being incurred. Interest capitalization continues as long as those activities and the incurrence of interest cost continues. The amount capitalized in an accounting period is determined by applying the capitalization rate (average interest rate) to the average amount of accumulated expenditures for the qualifying asset during the period. The capitalization rates are based on the interest rates applicable to borrowings outstanding during the period. Total interest capitalized (in thousands):

	As of November 30, 2015	As of August 31, 2015
Total interest capitalized	$ 7,076	$ 6,961

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Total interest capitalized (in thousands):

	Three Months Ended November 30,	
	2015	2014
Interest capitalized	$294	$616

The Company also recorded within accounts payable and other accrued expenses approximately $116,000 and $1.5 million respectively, as of November 30, 2015 and $458,000 and $1.5 million, respectively, as of August 31, 2015 of liabilities related to the acquisition and/or construction of property and equipment.

NOTE 4 – EARNINGS PER SHARE

The Company presents basic net income per share using the two-class method. The two-class method is an earnings allocation formula that treats a participating security as having rights to earnings that otherwise would have been available to common stockholders and that determines basic net income per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings that would have been available to common stockholders. A participating security is defined as a security that may participate in undistributed earnings with common stock. The Company's capital structure includes securities that participate with common stock on a one-for-one basis for distribution of dividends. These are the restricted stock awards and restricted stock units authorized within the 2013 Equity Incentive Award Plan. The Company determines the diluted net income per share by using the more dilutive of the two class-method or the treasury stock method and by including the basic weighted average of outstanding stock options in the calculation of diluted net income per share under the two-class method and including all potential common shares assumed issued in the calculation of diluted net income per share under the treasury stock method.

The following table sets forth the computation of net income per share for the three months ended November 30, 2015 and 2014 (in thousands, except per share amounts):

	Three Months Ended November 30,	
	2015	2014
Net income	$23,672	$20,647
Less: Allocation of income to unvested stockholders	(334)	(333)
Net earnings available to common stockholders	$23,338	$20,314
Basic weighted average shares outstanding	29,890	29,791
Add dilutive effect of stock options (two-class method)	6	8
Diluted average shares outstanding	29,896	29,799
Basic net income per share	$0.78	$0.68
Diluted net income per share	$0.78	$0.68

NOTE 5 – STOCKHOLDERS' EQUITY

Dividends

No dividends were declared by the Company's Board of Directors during the first three months of fiscal year 2016.
The following table summarizes the dividends declared and paid during fiscal year 2015.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

		First Payment				Second Payment			
Declared	Amount	Record Date	Date Paid	Date Payable	Amount	Record Date	Date Paid	Date Payable	Amount
2/4/15	$0.70	2/13/15	2/27/15	N/A	$0.35	8/14/15	8/31/2015	N/A	$0.35

The Company anticipates the ongoing payment of semi-annual dividends in subsequent periods, although the actual declaration of future dividends, the amount of such dividends, and the establishment of record and payment dates is subject to final determination by the Board of Directors at its discretion after its review of the Company's financial performance and anticipated capital requirements.

Comprehensive Income and Accumulated Other Comprehensive Loss

The following tables disclose the effects of each component of other comprehensive income (loss), net of tax (in thousands):

	Three Months Ended November 30, 2015			
	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments	Total
Beginning balance, September 1, 2015	$(100,540)	$(113)	$(859)	$(101,512)
Other comprehensive income (loss)	(472)	(4)	(120)	(596)
Ending balance, November 30, 2015	$(101,012)	$(117)	$(979)	$(102,108)

	Three Months Ended November 30, 2014			
	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments	Total
Beginning balance, September 1, 2014	$(50,410)	$113	$1,011	$(49,286)
Other comprehensive income (loss)	(11,651)	(11)	2,243	(9,419)
Ending balance, November 30, 2014	$(62,061)	$102	$3,254	$(58,705)

	Twelve Months Ended August 31, 2015			
	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments	Total
Beginning balance, September 1, 2014	$(50,410)	$113	$1,011	$(49,286)
Other comprehensive income (loss)	(50,130)	65	(1,770)	(51,835)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(291)[2]	(100)[1][3]	(391)
Ending balance, August 31, 2015	$(100,540)	$(113)	$(859)	$(101,512)

(1) See Note 9 - Derivative Instruments and Hedging Activities.

(2) Amounts reclassified from accumulated other comprehensive income (loss) related to the minimum pension liability are included in warehouse club operations in the Company's Consolidated Statements of Income.

(3) Amounts reclassified from accumulated other comprehensive income (loss) for settlement of derivative instruments are included in other income (expense), net in the Company's Consolidated Statements of Income.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Retained Earnings Not Available for Distribution

The following table summarizes retained earnings designated as legal reserves of various subsidiaries which cannot be distributed as dividends to PriceSmart, Inc. according to applicable statutory regulations (in thousands):

	November 30, 2015	August 31, 2015
Retained earnings not available for distribution	$ 5,061	$ 5,015

NOTE 6 – STOCK BASED COMPENSATION

The three types of equity awards offered by the Company are stock options (“options”), restricted stock awards (“RSAs”) and restricted stock units (“RSUs”). Compensation related to options is accounted for by applying the valuation technique based on the Black-Scholes model. Compensation related to RSAs and RSUs is based on the fair market value at the time of grant with the application of an estimated forfeiture rate. The Company recognizes the compensation cost related to these awards over the requisite service period as determined by the grant, amortized ratably or on a straight line basis over the life of the grant. The Company utilizes “modified grant-date accounting” for true-ups due to actual forfeitures at the vesting dates. The Company records the tax savings resulting from tax deductions in excess of expense for stock-based compensation as additional paid-in capital and the tax deficiency resulting from stock-based compensation in excess of the related tax deduction as a reduction in paid-in capital, based on the Tax Law Ordering method. In addition, the Company reflects the tax savings (deficiency) resulting from the taxation of stock-based compensation as a financing cash flow in its consolidated statement of cash flows, rather than as operating cash flows.

RSAs have the same cash dividend and voting rights as other common stock and are considered to be currently issued and outstanding shares of common stock. Shares of common stock subject to RSUs are not issued nor outstanding until vested, and RSUs do not have the same dividend and voting rights as common stock. However, all outstanding RSUs have accompanying dividend equivalents, requiring payment to the employees and directors with unvested RSUs of amounts equal to the dividend they would have received had the shares of common stock underlying the RSUs been actually issued and outstanding. Payments of dividend equivalents to employees are recorded as compensation expense.

The Company adopted the 2013 Equity Incentive Award Plan (the "2013 Plan") for the benefit of its eligible employees, consultants and non-employee directors on January 22, 2013. The 2013 Plan provides for awards covering up to (1) 600,000 shares of common stock plus (2) the number of shares that remained available for issuance as of January 22, 2013 under three equity participation plans previously maintained by the Company. The number of shares reserved for issuance under the 2013 Plan increases during the term of the plan by the number of shares relating to awards outstanding under the 2013 Plan or certain prior plans that expire, or are forfeited, terminated, canceled or repurchased, or are settled in cash in lieu of shares. However, in no event will more than an aggregate of 1,233,897 shares of the Company’s common stock be issued under the 2013 Plan. The following table summarizes the shares authorized and shares available for future grants:

	Shares authorized for issuance as of November 30, 2015 (including shares originally authorized for issuance under the prior plans)	Shares available to grant	
		November 30, 2015	August 31, 2015
2013 Plan	944,905	645,863	847,876

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PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes the components of the stock-based compensation expense (in thousands), which are included in general and administrative expense and warehouse club operations in the consolidated statements of income:

	Three Months Ended November 30,	
	2015	2014
Options granted to directors	$25	$27
Restricted stock awards	1,701	1,249
Restricted stock units	374	280
Stock-based compensation expense	$2,100	$1,556

The following tables summarize other information related to stock-based compensation:

	As of November 30,	
	2015	2014
Remaining unrecognized compensation cost (in thousands)	$33,477	$18,002
Weighted average period of time over which this cost will be recognized (years)	5	6

	Three Months Ended November 30,	
	2015	2014
Excess tax benefit (deficiency) on stock-based compensation (in thousands)	—	—

The Company began issuing restricted stock awards in fiscal year 2006 and restricted stock units in fiscal year 2008. The restricted stock awards and units vest over a period of up to ten years, and the unvested portion of the award is forfeited if the employee or non-employee director leaves the Company before the vesting period is completed. Restricted stock awards and units activity for the period was as follows:

	Three Months Ended November 30,	
	2015	2014
Grants outstanding at beginning of period	366,021	488,416
Granted	202,396	—
Forfeited	(383)	—
Vested	—	—
Grants outstanding at end of period	568,034	488,416

The following table summarizes the weighted average per share grant date fair value for restricted stock awards and units for the period:

	Three Months Ended November 30,	
Weighted Average Grant Date Fair Value	2015	2014
Restricted stock awards and units granted	$84.86	$—
Restricted stock awards and units vested	$—	$—
Restricted stock awards and units forfeited	$—	$—

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PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes the total fair market value of restricted stock awards and units vested for the period (in thousands):

	Three Months Ended November 30,	
	2015	2014
Total fair market value of restricted stock awards and units vested	$—	$—

At the vesting dates of restricted stock awards, the Company repurchases shares at the prior day's closing price per share, with the funds used to pay the employees' minimum statutory tax withholding requirements. The Company expects to continue this practice going forward. The following table summarizes this activity during the period:

	Three Months Ended November 30,	
	2015	2014
Shares repurchased	—	—
Cost of repurchase of shares (in thousands)	$—	$—

The Company reissues treasury shares as part of its stock-based compensation programs. The following table summarizes the treasury shares reissued:

	Three Months Ended November 30,	
	2015	2014
Reissued treasury shares	—	—

The following table summarizes the stock options outstanding:

	November 30, 2015	August 31, 2015
Stock options outstanding	20,000	20,000

Due to the substantial shift from the use of stock options to restricted stock awards and units, the Company believes stock option activity is no longer significant and that any further disclosure on options is not necessary.

NOTE 7 – COMMITMENTS AND CONTINGENCIES

Legal Proceedings

From time to time, the Company and its subsidiaries are subject to legal proceedings, claims and litigation arising in the ordinary course of business and property ownership. The Company evaluates such matters on a case by case basis, and vigorously contests any such legal proceedings or claims which the Company believes are without merit. The Company establishes an accrual for legal proceedings if and when those matters reach a stage where they present loss contingencies that are both probable and reasonably estimable. In such cases, there may be a possible exposure to loss in excess of any amounts accrued. The Company monitors those matters for developments that would affect the likelihood of a loss and the accrued amount, if any, thereof, and adjusts the amount as appropriate. If the loss contingency at issue is not both probable and reasonably estimable, the Company does not establish an accrual, but will continue to monitor the matter for developments that will make the loss contingency both probable and reasonably estimable. If it is at least a reasonable possibility that a material loss will occur, the Company will provide disclosure regarding the contingency. The Company believes that the final disposition of the pending legal proceedings, claims and litigation will not have a material adverse effect on its financial position, results of operations or liquidity. It is possible, however, that the Company's future results of operations for a particular quarter or fiscal year could be impacted by changes in circumstances relating to such matters.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Taxes

The Company is required to file federal and state tax returns in the United States and various other tax returns in foreign jurisdictions. The preparation of these tax returns requires the Company to interpret the applicable tax laws and regulations in effect in such jurisdictions, which could affect the amount of tax paid by the Company. The Company, in consultation with its tax advisors, bases its tax returns on interpretations that are believed to be reasonable under the circumstances. The tax returns, however, are subject to routine reviews by the various taxing authorities in the jurisdictions in which the Company files its returns. As part of these reviews, a taxing authority may disagree with respect to the interpretations the Company used to calculate its tax liability and therefore require the Company to pay additional taxes.

The Company accrues an amount for its estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained.

In evaluating the exposure associated with various non-income tax filing positions, the Company accrues for probable and estimable exposures for non-income tax related tax contingencies. As of November 30, 2015 and August 31, 2015, the Company has recorded within other accrued expenses a total of $4.3 million and $4.1 million, respectively, for various non-income tax related tax contingencies.

While the Company believes the recorded liabilities are adequate, there are inherent limitations in projecting the outcome of litigation, in estimating probable additional income tax liability taking into account uncertain tax positions and in evaluating the probable additional tax associated with various non-income tax filing positions. As such, the Company is unable to make a reasonable estimate of the sensitivity to change of estimates affecting its recorded liabilities. As additional information becomes available, the Company assesses the potential liability and revises its estimates as appropriate.

During the first quarter of fiscal year 2015, the Company received provisional tax assessments with respect to deductibility and withholdings. These payments and assessments are discussed in further detail within Note 2, Income Taxes.

Other Commitments

The Company is committed under non-cancelable operating leases for the rental of facilities and land. Future minimum lease commitments for facilities under these leases with an initial term in excess of one year are as follows (in thousands):

Years ended November 30,	Open Locations[1]
2016	$7,952
2017	10,466
2018	10,505
2019	10,319
2020	9,659

Thereafter	93,815
Total	$142,716

(1) Operating lease obligations have been reduced by approximately $215,000 to reflect sub-lease income. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.

The Company is also committed to non-cancelable construction services obligations for various warehouse club developments and expansions. As of November 30, 2015 and August 31, 2015, these commitments were approximately $13.6 million and $12.3 million, respectively, for construction services not yet rendered.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company has entered into a land purchase option agreement that has not been recorded as a commitment, for which the Company has recorded within the balance sheet approximately $200,000 within construction in process. The land purchase option agreement can be canceled at the sole option of the Company. The Company does not have a time table of when or if it will exercise this land purchase option, due to the uncertainty related to the completion of the Company's due diligence review. The Company's due diligence review includes evaluations of the legal status of the property, the zoning and permitting issues related to acquiring approval for the construction and operation of a warehouse club and any other issues related to the property itself that could render the property unsuitable or limit the property's economic viability as a warehouse club site. If the purchase option agreement is exercised, the cash use would be approximately $8.1 million.

See Note 10 - Unconsolidated Affiliates for a description of additional capital contributions that may be required in connection with joint ventures to develop commercial centers adjacent to PriceSmart warehouse clubs in Panama and Costa Rica.

The Company contracts for distribution center services in Mexico. The contract for this distribution center's services expires on December 31, 2017, with the applicable fees and rates to be reviewed at the beginning of each calendar year. Future minimum service commitments related to this contract through the end of the contract term is approximately $290,000.

NOTE 8 – DEBT

Short-term borrowings consist of lines of credit which are secured by certain assets of the Company and its subsidiaries and in some cases are guaranteed by the Company as summarized below (in thousands):

	Total Amount of Facilities	Facilities Used Short-term Borrowings	Letters of Credit	Facilities Available	Weighted average interest rate	
November 30, 2015	$57,656	$1,935	$87	$55,634	5.9	%
August 31, 2015	$57,691	$6,606	$728	$50,357	5.9	%

As of November 30, 2015 and August 31, 2015, the Company had approximately $40.0 million of short-term facilities in the U.S. that require compliance with certain quarterly financial covenants, which include debt service and leverage ratios. As of November 30, 2015 and August 31, 2015, the Company was in compliance with respect to these covenants. Each of the facilities expires annually and is normally renewed.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table provides the changes in long-term debt for the three months ended November 30, 2015:

(Amounts in thousands)		Current Portion of Long-term debt		Long-term debt					
	Developed Lots	Single Family	Multi-family	Commercial	Total	Single Family	Commercial	Total	Total Acreage
Austin									
Barton Creek	122	358	249	368	975	510	28	538	1,513
Lantana	-	-	-	-	-	-	223	223	223
Circle C	59a	-	-	265	265	148a	122	270	535
W Austin Hotel & Residences	-	-	-	2b	2	-	-	-	2
San Antonio									
Camino Real	-	-	-	-	-	-	2	2	2
Total	181	358	249	635	1,242	658	375	1,033	2,275

a. Relates to Meridian, an 800-lot residential development.

b. Represents a city block in downtown Austin planned for a mixture of hotel, residential, retail, office and entertainment uses.

Our other Austin holdings at September 30, 2009, consisted of two 75,000-square-foot office buildings at 7500 Rialto Boulevard (7500 Rialto) located in our Lantana development, a 22,000-square-foot retail complex representing phase one of Barton Creek Village and two retail buildings totaling 21,000 square feet at the 5700 Slaughter project in the Circle C community.

The sharp decline in activity in the real estate market, among other factors, significantly impacted our consolidated financial results. In the third quarter of 2009, our revenues totaled $3.3 million and our net loss attributable to common stock totaled $1.6 million, compared with revenues of $6.9 million and a net loss attributable to common stock of $0.4 million for the third quarter of 2008. For the first nine months of 2009, our revenues totaled $8.4 million and our net loss attributable to common stock totaled $4.7 million, compared with revenues of $16.1 million and a net loss attributable to common stock of $1.9 million for the first nine months of 2008. Our financial condition and results of operations are highly dependent upon market conditions for real estate activity in Austin, Texas. Our future operating cash flows and, ultimately, our ability to develop our properties and expand our business will be largely dependent on the level of our real estate sales. In turn, these sales will be significantly affected by future real estate market conditions in Austin, Texas, including development costs, interest rate levels, the availability of credit to finance real estate transactions, demand for residential and commercial real estate, and regulatory factors including our land use and development entitlements.

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Recent economic conditions have also resulted in a general decline in leasing activity across the United States (U.S.), and have caused vacancy rates to increase in most markets, including Austin, Texas. Investment sales activity in the U.S. declined sharply during 2008 because of, among other factors, limited availability and increased cost of financing, especially the absence of securitized debt, which was the source of heightened investment activity, and the resulting gap between buyer and seller expectations of value.

Periods of economic slowdown or recession, rising interest rates, tightening of the credit markets, declining demand for or increased supply of real estate, or the public perception that any of these events may occur can adversely affect our business. These conditions could result in a general decline in rents, which in turn would reduce revenue from leases. In addition, these conditions could lead to a decline in property values as well as a decline in funds invested in commercial real estate and related assets, which in turn may reduce revenues from leases and development fees.

U.S. credit markets have yet to fully recover, and this lingering problem is impacting the broader U.S. economy. Commercial real estate lenders have substantially tightened underwriting standards or have withdrawn from the lending market, materially impacting liquidity in the real estate debt markets, making financing terms for owners of retail properties less attractive, and in certain cases resulting in the unavailability of certain types of debt financing. Tighter lending standards and higher borrowing costs have exerted downward pressure on the value and liquidity of real estate assets which will impact the values we could obtain from the sale of our properties. These factors may make it more difficult for us to sell properties or may adversely affect the price we receive for properties that we do sell, as prospective buyers may experience increased costs of debt financing or difficulties in obtaining such financing. Our future performance will, in part, be dependent upon the recovery of the credit markets and the underlying strength of the U.S. economy.

BUSINESS STRATEGY

Over the past several years, we have successfully worked cooperatively with the City of Austin (the City) to obtain approvals that allow the development of our properties to proceed in a timely manner while protecting the environment. We believe the desirable location and overall quality of our properties, in combination with the land use and development entitlements we have obtained, will under normal market conditions command a premium over the value of other Austin-area properties.

Our long-term success will depend on our ability to maximize the value of our real estate through obtaining required approvals that permit us to develop and sell our properties in a timely manner at a reasonable cost. We must incur significant development expenditures and secure additional permits prior to the development and sale of certain properties. In addition, we continue to pursue additional development opportunities, and currently believe we can obtain financing necessary for developing our properties, although our ability to obtain financing in the future may be impacted by current U.S. economic conditions. See “Risk Factors” located in Item 1A of our 2008 Form 10-K.

REVISIONS OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS

As discussed in Note 2, an accounting matter was identified in connection with the preparation of our financial results for the year ended December 31, 2008, that required revisions of our consolidated financial statements for the three-month and nine-month periods ended September 30, 2008. Management’s discussion and analysis has been updated to discuss changes in comparative results of operations after considering the impact of the item discussed in Note 2.

DEVELOPMENT AND OTHER ACTIVITIES

W Austin Hotel & Residences. In 2005, the City selected our proposal to develop a mixed-use project in downtown Austin immediately north of the new City Hall complex. The W Austin Hotel & Residences project includes an entire city block and is planned for a mixture of hotel, residential, retail, office and entertainment uses. In 2006, we acquired the property for $15.1 million. We have executed agreements with Starwood Hotels & Resorts Worldwide, Inc. for the development of a W Hotel & Residences on the site. In May 2007, we announced our proposed partnership with Canyon-Johnson Urban Fund II, L.P. (Canyon-Johnson) for the development of the W Austin Hotel & Residences project. The grand opening

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for the onsite sales center was held in conjunction with the groundbreaking ceremony in October 2007. Effective May 1, 2008, we entered into a joint venture with Canyon-Johnson for the development of the project (see Note 4). A construction loan with Corus Bank N.A. (Corus) was signed effective May 2, 2008. Construction of the $300 million project commenced in the second quarter of 2008 and is proceeding as scheduled.

On June 26, 2009, the construction loan agreement with Corus was assigned to a subsidiary of Stratus, which is managed by Stratus and Canyon-Johnson, in exchange for a pay down of $250,000 of the outstanding principal balance of $2.1 million. As a result, Corus was no longer the lender, and in the second quarter of 2009, we recognized a $0.2 million loss on extinguishment of debt, which includes the write-off of unamortized deferred loan costs in the amount of $2.1 million.

On October 21, 2009, the subsidiary assigned and transferred the project construction loan documents to Beal Bank Nevada (Beal Bank). In connection with the assignment, the joint venture executed an amended and restated loan agreement, an amended and restated promissory note and related loan documents with Beal Bank (Beal Bank loan agreement). Pursuant to the Beal Bank loan agreement, the joint venture may borrow up to an aggregate of $120 million to fund the construction, development and marketing costs of the W Austin Hotel & Residences project. An initial advance under the Beal Bank loan agreement of $3.4 million was made at closing.

As of September 30, 2009, capital contributions to the joint venture totaled $101.3 million, of which we contributed $42.2 million and Canyon-Johnson contributed $59.1 million. The next advance under the Beal Bank loan agreement is expected to occur in mid-2010 and thereafter advances are expected to be made monthly until the loan is fully funded. As a condition to further funding from the Beal Bank loan agreement, the joint venture must invest at least $180 million. Previously, when Corus was the construction lender, the joint venture was required to invest total equity of $128 million ($53 million from us and $75 million from Canyon-Johnson). As a result of changing construction lenders, $52 million of additional equity is now required. The joint venture is currently pursuing third parties to fund all or a portion of the $52 million. To the extent acceptable third-party or other financing is not secured, the joint venture may be obligated to fund the additional capital necessary to meet the $180 million pre-funding requirement under the Beal Bank loan agreement.

Crestview Station. In 2005, we formed a joint venture with Trammell Crow to acquire an approximate 74-acre tract at the intersection of Airport Boulevard and Lamar Boulevard in Austin, Texas, for $7.7 million. The property, known as Crestview Station, is a single-family, multi-family, retail and office development, which is located on the site of a future commuter rail line approved by City of Austin voters. With Trammell Crow, we have completed environmental remediation, which the State of Texas certified as complete in 2007, and permitting of the property. The initial phase of utility and roadway infrastructure is complete. Crestview Station sold substantially all of its multi-family and commercial properties in 2007 and one commercial site in the first quarter of 2008. The joint venture retained the single-family component of Crestview Station and one commercial site. The joint venture is currently processing permits to develop Crestview Station as a 450-unit transit-oriented neighborhood. At September 30, 2009, our investment in the Crestview Station project totaled $3.5 million and the joint venture partnership had $8.2 million of outstanding debt, of which we guarantee $1.4 million. To the extent the joint venture does not have funds available, we and Trammell Crow will equally fund monthly interest payments on the outstanding loan balance and scheduled principal payments beginning in 2011.

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Residential. As of September 30, 2009, the number of our residential developed lots, lots under development and potential development by area are shown below (excluding lots and units associated with our Canyon-Johnson and Crestview Station joint ventures):

	Residential Lots			
	Developed	Under Development	Potential Development a	Total
Barton Creek:				
Calera:				
Calera Court Courtyard Homes	2	-	-	2
Calera Drive	8	-	-	8
Verano Drive	67	-	-	67
Amarra Drive:				
Phase I Lots	7	-	-	7
Phase II Lots	35	-	-	35
Phase II and III Townhomes	-	-	221	221
Phase III	-	89	-	89
Mirador Estate	2	-	-	2
Wimberly Lane Phase II	1	-	-	1
Section N Multi-familyb	-	-	1,860	1,860
Other Barton Creek Sections	-	-	154	154
Circle C:				
Meridian	59	-	57	116
Total Residential Lots	181	89	2,292	2,562

a. Our development of the properties identified under the heading "Potential Development" is dependent upon the approval of our development plans and permits by governmental agencies, including the City. Those governmental agencies may either not approve one or more development plans and permit applications related to such properties or require us to modify our development plans. Accordingly, our development strategy with respect to those properties may change in the future. The timing for development of these properties has not been determined. While we may be proceeding with approved infrastructure projects on some of these properties, they are not considered to be "under development" for disclosure in this table unless other development activities necessary to fully realize the properties' intended final use are in progress or scheduled to commence in the near term.

b. Represents 1,860 potential units on 174 acres.

Calera. Calera is a residential subdivision with plat approval for 155 lots. During 2004, we began construction of 16 courtyard homes at Calera Court, the 16-acre initial phase of the Calera subdivision. The second phase of Calera, Calera Drive, consisting of 53 single-family lots, many of which adjoin the Fazio Canyons Golf Course, received final plat and construction permit approval in 2005. Construction of the final phase, known as Verano Drive, was completed in July 2008 and includes 71 single-family lots. As of September 30, 2009, two courtyard homes at Calera Court, eight lots at Calera Drive and 67 lots at Verano Drive remained unsold.

Amarra Drive. Amarra Drive Phase I, which is the initial phase of the Amarra Drive subdivision, was completed in 2007 and includes eight lots with sizes ranging from approximately one to four acres, some of which are course-side lots on the Fazio Canyons Golf Course and others are secluded lots adjacent to the Nature Conservancy of Texas. In

2008, we commenced development of Amarra Drive Phase II, which consists of 35 lots on 51 acres. Development was substantially completed in October 2008, but no sales have occurred.

Mirador Estate. The Mirador subdivision consists of 34 estate lots, with each lot averaging approximately 3.5 acres in size. As of September 30, 2009, two Mirador estate lots remained unsold.

Wimberly Lane. Wimberly Lane included two phases, with phase one consisting of 75 residential lots and phase two consisting of 47 residential lots. As of September 30, 2009, one Wimberly Lane lot remained unsold.

Circle C. We are developing the Circle C community based on the entitlements secured in our Circle C settlement with the City. Our Circle C settlement, as amended in 2004, permits development of 1.16 million square feet of commercial space, 504 multi-family units and 830 single family residential lots. Meridian is an 800-lot residential development at the Circle C community. Development of Meridian included our contracts with three national homebuilders to complete the construction and sales of 494 lots. As of September 30, 2009, 30 lots remained unsold and 24 lots are expected to be sold in the fourth

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quarter of 2009 for $1.6 million. The remaining six lots are expected to be sold for $0.4 million in the first quarter of 2010.

In 2006, we signed another contract with a national homebuilder for 42 additional lots. Development of those lots was substantially completed in April 2008. In June 2009, the contract was terminated by the homebuilder. As of the date the contract was terminated, there were 30 remaining lots. In connection with the termination, the homebuilder forfeited a deposit of $0.6 million, which we recorded as other income in the second quarter of 2009. We are currently pursuing development contracts with other homebuilders for the remaining lots. One lot was sold in August 2009 for $0.1 million and 29 lots remained unsold as of September 30, 2009. The final phase of Meridian is expected to consist of 57 one-acre lots.

Commercial. As of September 30, 2009, the number of square feet of our commercial property developed, under development and our potential development are shown below (excluding property associated with our Canyon-Johnson and Crestview Station joint ventures):

	Commercial Property			
	Developed	Under Development	Potential Development a	Total
Barton Creek:				
Barton Creek Village Phase I	22,000	-	-	22,000
Barton Creek Village Phase II	-	-	18,000	18,000
Entry Corner	-	-	5,000	5,000
Amarra Retail/Office	-	-	90,000	90,000
Section N	-	-	1,500,000	1,500,000
Circle C:				
Chase Ground Lease	4,000	-	-	4,000
Tract 106	21,000	-	-	21,000
Tract 107	-	80,000	-	80,000
Tract 110	-	-	760,000	760,000
Tract 101	-	-	90,000	90,000
Tract 102	-	-	25,000	25,000
Tract 114	-	-	5,000	5,000
Lantana:				
7500 Rialto	150,000	-	-	150,000
Advanced Micro Devices Option Tracts	-	-	760,000	760,000
Tract GR1	-	-	325,000	325,000
Tract G07	-	-	210,000	210,000
Tract CS5	-	-	175,000	175,000
Tract CS1-CS3	-	-	150,000	150,000
Tract LR1	-	-	75,000	75,000
Tract L04	-	-	70,000	70,000
Austin 290 Tract	-	-	20,000	20,000
Total Square Feet	197,000	80,000	4,278,000	4,555,000

a. Our development of the properties identified under the heading “Potential Development” is dependent upon the approval of our development plans and permits by governmental agencies, including the City. Those governmental agencies may either not approve one or more development plans and permit applications related to such properties or require us to modify our development plans. Accordingly, our development strategy with respect to those properties may change in the future. The timing for development of these properties has not been determined. While we may be proceeding with approved infrastructure projects on some of these properties, they are not considered to be “under development” for disclosure in this table unless other development activities necessary to fully realize the properties’ intended final use are in progress or scheduled to commence in the near term.

Barton Creek. The first phase of the Barton Creek Village includes a 22,000-square-foot retail complex and a 3,300-square-foot bank building within this retail complex. As of September 30, 2009, the retail complex was 84 percent leased and the bank building is leased through 2022.

Circle C. During the third quarter of 2008, we completed the construction of two retail buildings, totaling 21,000 square feet, at the 5700 Slaughter project. This retail project also includes a 4,000-square-foot bank building on an existing ground lease. Leasing for the two retail buildings is under way with 32 percent of the 21,000-square-foot retail complex leased as of September 30, 2009. We expect the 21,000-square-foot retail complex to be substantially leased by the end of 2009.

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The Circle C community also includes Parkside Village, an 80,000-square-foot planned retail project. The project will be developed in two phases. The first phase will consist of a 34,000-square-foot building to accommodate a full-service restaurant and theater. The second phase will consist of three tilt-wall retail buildings at 14,775 square feet, 8,075 square feet and 7,600 square feet, and two pads available for ground leases. We are pursuing final permits and entitlements to position the project for commencement of construction when appropriate.

Lantana. Lantana is a partially developed, mixed-use real-estate development project. Lantana includes two 75,000-square-foot office buildings at 7500 Rialto. As of September 30, 2009, occupancy was 71 percent for the original office building and 94 percent for the second office building. We are actively pursuing tenants to fill the available office space at this property. As of September 30, 2009, we had remaining entitlements for approximately 1.0 million square feet of office and retail use on 223 acres. Regional utility and road infrastructure is in place with capacity to serve Lantana at full build-out permitted under our existing entitlements.

RESULTS OF OPERATIONS

We are continually evaluating the development potential of our properties and considering opportunities to enter into transactions involving our properties. As a result, and because of numerous other factors affecting our business activities as described herein, our past operating results are not necessarily indicative of our future results.

Summary operating results follow (in thousands):

	Third Quarter		Nine Months	
	2009	2008	2009	2008
Revenues:				
Real estate operations	$ 2,181	$ 5,751	$ 5,070	$ 12,786
Commercial leasing	1,163	1,158	3,296	3,278
Total revenues	$ 3,344	$ 6,909	$ 8,366	$ 16,064
Operating loss	$ (2,375)	$ (1,147)	$ (7,904)	$ (4,270)
Benefit from income taxes	$ 844	$ 268	$ 2,448	$ 660
Net loss attributable to Stratus common stock	$ (1,553)	$ (447)	$ (4,734)	$ (1,851)

We have two operating segments, “Real Estate Operations” and “Commercial Leasing” (see Note 10). The following is a discussion of our operating results by segment.

Real Estate Operations

Summary operating results for real estate operations follow (in thousands):

	Third Quarter		Nine Months	
	2009	2008	2009	2008
Revenues:				
Developed property sales	$ 2,116	$ 5,691	$ 4,201	$ 11,953
Undeveloped property sales	-	-	-	41
Commissions, management fees and other	65	60	869	792

Total revenues		2,181		5,751		5,070		12,786
Cost of sales, including depreciation		(2,760)		(5,007)		(6,982)		(11,310)
General and administrative expenses		(1,134)		(1,482)		(3,636)		(4,538)
Operating loss	$	(1,713)	$	(738)	$	(5,548)	$	(3,062)

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Developed Property Sales. Residential property sales for the third-quarter and nine-month periods of 2009 and 2008 included the following (revenues in thousands):

	Third Quarter			
	2009		2008	
	Lots	Revenues	Lots	Revenues
Barton Creek				
Calera Court Courtyard Homes	1	$ 549	1	$ 643
Verano Drive	1	450	3	1,875
Circle C				
Meridian	16	1,117	48	3,173
Total Residential	18	$ 2,116	52	$ 5,691

	Nine Months			
	2009		2008	
	Lots	Revenues	Lots	Revenues
Barton Creek				
Calera Court Courtyard Homes	2	$ 1,149	2	$ 1,278
Wimberly Lane Phase II				
Standard Homebuilder	-	-	1	265a
Verano Drive	1	450	3	1,875
Circle C				
Meridian	39	2,602	103	7,125
Deerfieldb	-	-	21	1,410
Total Residential	42	$ 4,201	130	$ 11,953

a. Includes $0.1 million for homebuilder contract termination fee.

b. In 2004, we acquired the Deerfield property in Plano, Texas, for $7.0 million. We executed agreements with a national homebuilder, whereby the homebuilder paid us $1.4 million for an option to purchase all 234 lots over 36 monthly take-downs. In 2005, we executed a revised agreement with the homebuilder, increasing the lot sizes and average purchase price to $67,150 based on a new total of 224 lots. In January 2008, we sold the final 21 lots for $1.4 million.

The decrease in developed property sales revenues to $2.1 million for the third quarter of 2009 and $4.2 million for the first nine months of 2009, from $5.7 million for the third quarter of 2008 and $12.0 million for the first nine months of 2008 resulted from a lower number of lots sold primarily caused by deterioration of demand and available financing in the real estate market as further discussed under "Overview." Although real estate market conditions have resulted in fewer lot sales, we have not made significant changes to our lot prices.

Cost of Sales. Cost of sales totaled $2.8 million for the third quarter of 2009, $5.0 million for the third quarter of 2008, $7.0 million for the first nine months of 2009 and $11.3 million for the first nine months of 2008, and includes cost of property sold, ongoing project expenses and allocated overhead costs, partially offset by reductions for certain Municipal Utility District (MUD) reimbursements. Accordingly, while profit margins on developed property sales remain positive, the inclusion of ongoing project expenses and allocated overhead costs in cost of sales results in a negative gross margin. Most of the sales for the 2009 and 2008 periods were Circle C lots, which have lower profit margins than Barton Creek lots. Cost of sales also included reductions for Barton Creek MUD reimbursements totaling less than $0.1 million for the third quarter and first nine months of 2009 and $0.1 million for the first nine months of 2008.

We are projecting continued lower levels of lot sales in the next several quarters because of the continued weakness in the U.S. and Austin real estate markets.

General and Administrative Expenses. Consolidated general and administrative expenses increased to $1.8 million for the third quarter of 2009 from $1.7 million for the third quarter of 2008, and increased to $5.8 million for the first nine months of 2009 from $5.3 million for the first nine months of 2008, primarily because of higher fees for professional services associated with SEC filings. General and administrative

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expenses allocated to real estate operations decreased to $1.1 million for the third quarter of 2009 from $1.5 million for the third quarter of 2008, and decreased to $3.6 million for the first nine months of 2009 from $4.5 million for the first nine months of 2008 primarily as a result of a lower allocation of general and administrative expenses to the real estate operations segment in 2009 because of lower projected real estate operations revenues.

Commercial Leasing
Summary commercial leasing operating results follow (in thousands):

	Third Quarter		Nine Months	
	2009	2008	2009	2008
Rental income	$ 1,163	$ 1,158	$ 3,296	$ 3,278
Rental property costs	(788)	(944)	(2,405)	(2,683)
Depreciation	(353)	(382)	(1,051)	(1,064)
General and administrative expenses	(684)	(241)	(2,196)	(739)
Operating loss	$ (662)	$ (409)	$ (2,356)	$ (1,208)

Rental Income. While rental income for the 2009 periods approximated the 2008 periods, rental income from 7500 Rialto was $0.1 million lower in each of the 2009 periods because of higher vacancies, compared to the 2008 periods; however, these 2009 decreases were offset by additional rental income from the new leases in 2009 at Barton Creek Village and 5700 Slaughter.

Rental Property Costs. Rental property costs decreased to $0.8 million for the third quarter of 2009 from $0.9 million for the third quarter of 2008 and $2.4 million for the first nine months of 2009 from $2.7 million for the first nine months of 2008. The decrease in rental property costs in the 2009 periods is primarily the result of a decrease in personnel and operating costs associated with the property management function, which was outsourced to a third party in the fourth quarter of 2008. The decrease in the 2009 nine-month period was partly offset by higher costs from 5700 Slaughter, which commenced operations in July 2008.

General and Administrative Expenses. General and administrative expenses from commercial leasing increased to $0.7 million for the third quarter of 2009 from $0.2 million for the third quarter of 2008, and increased to $2.2 million for the first nine months of 2009 from $0.7 million for the first nine months of 2008, primarily as a result of a lower allocation of general and administrative expenses to the real estate operations segment in 2009 because of lower projected real estate operations revenues.

Non-Operating Results
Interest Income and Other. Interest income totaled $0.1 million in the third quarter of 2009, $0.3 million in the third quarter of 2008, $0.3 million in the first nine months of 2009 and $1.4 million in the first nine months of 2008. The decrease in interest income in the first nine months of 2009 primarily reflects $0.6 million less of Barton Creek MUD reimbursements. Interest income included interest on Barton Creek MUD reimbursements totaling $0.1 million in the third quarter of 2009, $0.2 million in the third quarter of 2008, $0.3 million in the first nine months of 2009 and $0.9 million in the first nine months of 2008. Additionally, the decrease in interest income reflects a decrease in average cash balances during the 2009 periods compared to the 2008 periods.

We recorded other income of $0.6 million in the first nine months of 2009 for a forfeited deposit in connection with the termination of a homebuilder contract for certain lots in the Circle C community.

Loss on Extinguishment of Debt. We recorded a loss on extinguishment of debt of $0.2 million in the first nine months of 2009, reflecting the assignment of the W Austin Hotel & Residences construction loan to a Stratus subsidiary (see Note 4).

Gain (Loss) on Interest Rate Cap Agreement. We recognized a loss on the interest rate cap agreement of less than $0.1 million in the third quarter of 2009, a gain of less than $0.1 million in the first nine months 2009, and losses of $0.1 million in the 2008 periods, reflecting the impact of changing interest rates on the fair value of this derivative instrument (see Note 5).

Equity in Unconsolidated Affiliate’s (Loss) Income. We account for our 50 percent interest in our unconsolidated affiliate, Crestview Station, using the equity method. Crestview Station sold substantially all of its multi-family and commercial properties in 2007 and one commercial site in the first quarter of 2008. Our equity in Crestview Station's (losses) earnings decreased to $(0.1) million for the third quarter of 2009 from $0.1 million for the third quarter of 2008, and decreased to $(0.3) million for the first nine months of 2009 from $0.4 million for the first nine months of 2008. The decrease in our equity in Crestview Station's (losses) earnings primarily reflects the losses recognized by Crestview Station in the 2009 periods, as there were no sales during the first nine months of 2009.

Benefit from Income Taxes. We recorded an income tax benefit of $0.8 million for the third quarter of 2009, $0.3 million for the third quarter of 2008, $2.4 million for the first nine months of 2009 and $0.7 million for the first nine months of 2008. The difference between our consolidated effective income tax rates for the first nine months of 2009 and 2008 and the U.S. federal statutory rate of 35 percent was primarily attributable to state income tax expense and other permanent items.

Net Loss Attributable to Noncontrolling Interest in Subsidiary. Net loss attributable to nonconrolling interest in subsidiary totaled less than $0.1 million in the third quarter of 2009, $0.1 million in the third quarter of 2008, $0.3 million in the first nine months of 2009 and $0.2 million in the first nine months of 2008 related to the W Austin Hotel & Residences project (see Note 4).

CAPITAL RESOURCES AND LIQUIDITY

At September 30, 2009, we had $24.9 million in cash and cash equivalents and $31.8 million in availability under our $45 million revolving credit facility, which matures in May 2010. In May 2009, we began making additional capital contributions to the W Austin Hotel & Residences project joint venture. Through September 30, 2009, we have funded $42.2 million and Canyon-Johnson has funded $59.1 million. Without additional financing, the joint venture may be obligated to fund approximately $79 million for the project costs after October 1, 2009, until funds under the Beal Bank loan agreement are available. The joint venture is actively seeking other financing options to fund the balance of the project costs that will not be funded by the construction loan once we and Canyon-Johnson have funded the required capital commitments (see Notes 4 and 12).

Comparison of Nine-Months 2009 and 2008 Cash Flows
Cash used in operating activities increased to $26.2 million during the first nine months of 2009, compared with $10.7 million during the first nine months of 2008, primarily because of a $7.8 million decrease in proceeds from developed property sales, a $10.7 million increase in cash used in development of real estate properties, a $1.7 million decrease in MUD reimbursements and a $1.3 million distribution of income from our unconsolidated affiliate, Crestview Station, received in the first nine months of 2008. As stated previously, the continued weakness in the U.S. real estate market has negatively affected sales of lots, and we expect this trend to continue in the near-term. Expenditures for purchases and development of real estate properties for the first nine months of 2009 and 2008 included development costs for properties held for sale, including the residential portion of the W Austin Hotel & Residences project ($26.6 million in 2009 and $10.4 million in 2008), and the Barton Creek, Lantana and Circle C communities. We received Barton Creek MUD reimbursements totaling $4.6 million in the first nine months of 2009 and $6.2 million in the first nine months of 2008. Capital expenditures for the W Austin Hotel & Residences project, including both residential and commercial leasing expenditures, are expected to approximate $26 million for the fourth quarter of 2009 and $110 million for the year 2010.

Cash used in investing activities totaled $13.3 million during the first nine months of 2009 and $8.6 million during the first nine months of 2008. Commercial leasing development expenditures for the first nine months of 2009 and 2008 included development costs for the W Austin Hotel & Residences project totaling $26.8 million in 2009 and $9.7 million in 2008. Other expenditures for commercial leasing properties primarily related to Barton Creek Village in the 2008 period. We also contributed capital of $1.5 million to Crestview Station in the first nine months of 2009 and received distributions representing a partial return of our investment in Crestview Station totaling $2.4 million in the first nine months of 2008. Crestview Station generated proceeds from sales in the 2008 period but had no sales or cash proceeds in the 2009 period. In addition, we received proceeds from matured U.S. treasury securities of $15.4 million in the first nine months of 2009.

Cash provided by financing activities totaled $47.3 million during the first nine months of 2009, which included $33.4 million of noncontrolling interest contributions from Canyon-Johnson for the W Austin Hotel & Residences project, $10.2 million in net borrowings from our revolving credit facility and $4.7 million in net borrowings from the Barton Creek Village term loan. Other debt repayments totaled $0.5 million, including a $250,000 payment to terminate the W Austin Hotel & Residences project loan with Corus (see "Development and Other Activities"). In the first nine months of 2009, we used $0.4 million to repurchase shares of our common stock on the open market (see below). Cash provided by financing activities totaled $15.3 million during the first nine months of 2008, which included $16.7 million of noncontrolling interest contributions from Canyon-Johnson for the W Austin Hotel & Residences project and $2.1 million of borrowings from the W Austin Hotel & Residences project loan, partly offset by $2.8 million of financing costs. In the first nine months of 2008, we used $0.5 million to repurchase shares of our common stock.

In 2001, our Board of Directors approved an open market share purchase program for up to 0.7 million shares of our common stock. During the third quarter of 2009, there were no purchases under this program. A total of 161,145 shares remain available under this program as of September 30, 2009. Our loan agreement with Comerica provides a limit of $6.5 million for common stock purchases after September 30, 2005, of which $0.9 million remained at September 30, 2009. The timing of future purchases of our common stock is dependent on many factors including the price of our common shares, our cash flows and financial position, and general economic and market conditions.

Credit Facility and Other Financing Arrangements

At September 30, 2009, we had total debt of $76.0 million, compared with $63.4 million at December 31, 2008. Our debt outstanding at September 30, 2009 consisted of the following:

- $10.2 million of borrowings outstanding and $2.9 million of letters of credit issued under our $45.0 million revolving credit facility with Comerica, resulting in availability of approximately $31.8 million. The revolving credit facility matures in May 2010.

- $40.0 million of borrowings outstanding under seven unsecured term loans, which include two $5.0 million loans, two $8.0 million loans, a $7.0 million loan and two $3.5 million loans, all of which will mature in December 2011.

- $21.1 million of borrowings outstanding under the Lantana promissory note, which matures in January 2018.

- $4.7 million of borrowings outstanding under a term loan secured by Barton Creek Village. The note bears interest at 6.25 percent per annum and matures in April 2014. Payments of interest and principal are due monthly beginning May 1, 2009.

Pursuant to an October 21, 2009, loan agreement with Beal Bank, the joint venture for the W Austin Hotel & Residences may borrow up to an aggregate of $120 million to fund the construction, development and marketing costs. Amounts borrowed under the Beal Bank loan agreement will bear interest at an annual rate equal to The Wall Street Journal Prime Rate, as it changes from time to time, plus 6¼ percent. The outstanding principal is due at maturity on October 21, 2014 (see Note 12).

NEW ACCOUNTING STANDARDS

Refer to Note 11 for discussion of new accounting standards.

CAUTIONARY STATEMENT

Our discussion and analysis contains forward-looking statements regarding future reimbursements for infrastructure costs, future events related to financing and regulatory matters, projected capital expenditures, the expected results of our business strategy, and other plans and objectives of management for future operations and activities. Important factors that could cause actual results to differ materially from our expectations include economic and business conditions, business opportunities that may be presented to and pursued by us, changes in laws or regulations and other factors, many of which are beyond our control, and other factors that are described in more detail under “Risk Factors” located in our 2008 Form 10-K.

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Item 4. Controls and Procedures.

(a) Evaluation of disclosure controls and procedures. Our chief executive officer and chief financial officer, with the participation of management, have evaluated the effectiveness of our "disclosure controls and procedures" (as defined in Rules 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934) and determined that our controls and procedures were effective as of the end of September 30, 2009.

(b) Changes in internal control. There was no change in our internal control over financial reporting that occurred during the quarter ended September 30, 2009, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following table sets forth shares of our common stock we repurchased during the three months ended September 30, 2009.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programsa	(d) Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programsa
July 1 to 31, 2009	-	-	-	161,145
August 1 to 31, 2009	-	-	-	161,145
September 1 to 30, 2009	-	-	-	161,145
Total	-	-	-	

a. In February 2001, our Board of Directors approved an open market share purchase program for up to 0.7 million shares of our common stock. The program does not have an expiration date. Our loan agreement with Comerica provides a limit of $6.5 million for common stock purchases after September 30, 2005. At September 30, 2009, $0.9 million remained under the Comerica agreement for purchases of common stock.

Item 6. Exhibits.

The exhibits to this report are listed in the Exhibit Index beginning on page E-1 hereof.

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SIGNATURE

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.

STRATUS PROPERTIES INC.

By: /s/ Erin D. Pickens

Erin D. Pickens
Senior Vice President and
Chief Financial Officer
(authorized signatory and
Principal Financial Officer)

Date: November 6, 2009

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STRATUS PROPERTIES INC.
EXHIBIT INDEX

Exhibit Number	Exhibit Title	Filed with this Form 10-Q	Incorporated by Reference Form	File No.	Date Filed
3.1	Amended and Restated Certificate of Incorporation of Stratus.		10-Q	000-19989	05/17/2004
3.2	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Stratus, dated May 14, 1998.		10-Q	000-19989	05/17/2004
3.3	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Stratus, dated May 25, 2001.		10-K	000-19989	03/22/2002
3.4	By-laws of Stratus, as amended as of November 6, 2007.		10-Q	000-19989	08/11/2008
10.1	Amended and Restated Construction Loan Agreement dated October 21, 2009, by and between CJUF II Stratus Block 21 LLC and Beal Bank Nevada.	X			
10.2	Amended and Restated Promissory Note dated October 21, 2009, by and between CJUF II Stratus Block 21 LLC and Beal Bank Nevada.	X			
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).	X			
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).	X			
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350.	X			
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350.	X			

Note: Certain instruments with respect to long-term debt of Stratus have not been filed as exhibits to this Quarterly Report on Form 10-Q since the total amount of securities authorized under any such instrument does not exceed 10 percent of the total assets of Stratus and its subsidiaries on a consolidated basis. Stratus agrees to furnish a copy of each such instrument upon request of the Securities and Exchange Commission.

E-1