

PRICESMART INC
Form 10-Q
April 05, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended February 28, 2018

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 (I.R.S. Employer
incorporation or organization) Identification No.)

Edgar Filing: PRICESMART INC - Form 10-Q

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 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 No

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

Large accelerated filer Accelerated filer Smaller Reporting Company
Non-accelerated filer (Do not check if a Emerging growth company
smaller reporting company)

Edgar Filing: PRICESMART INC - Form 10-Q

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The registrant had 30,418,544 shares of its common stock, par value \$0.0001 per share, outstanding at March 31, 2018.

PRICESMART, INC.

INDEX TO FORM 10-Q

	Page
<u>PART I - FINANCIAL INFORMATION</u>	
<u>ITEM 1.</u>	
<u>FINANCIAL STATEMENTS</u>	1
<u>CONSOLIDATED BALANCE SHEETS AS OF FEBRUARY 28, 2018 (UNAUDITED) AND AUGUST 31, 2017</u>	2
<u>CONSOLIDATED STATEMENTS OF INCOME FOR THE THREE AND SIX MONTHS ENDED FEBRUARY 28, 2018 AND 2017 - UNAUDITED</u>	4
<u>CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME FOR THE THREE AND SIX MONTHS ENDED FEBRUARY 28, 2018 AND 2017 - UNAUDITED</u>	5
<u>CONSOLIDATED STATEMENTS OF EQUITY FOR THE SIX MONTHS ENDED FEBRUARY 28, 2018 AND 2017 - UNAUDITED</u>	6
<u>CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE SIX MONTHS ENDED FEBRUARY 28, 2018 AND 2017 - UNAUDITED</u>	7
<u>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED</u>	9
<u>ITEM 2.</u>	
<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	30
<u>ITEM 3.</u>	
<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	52
<u>ITEM 4.</u>	
<u>CONTROLS AND PROCEDURES</u>	53
<u>PART II - OTHER INFORMATION</u>	
<u>ITEM 1.</u>	
<u>LEGAL PROCEEDINGS</u>	54
<u>ITEM 1A.</u>	
<u>RISK FACTORS</u>	54
<u>ITEM 2.</u>	
<u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	54
<u>ITEM 3.</u>	
<u>DEFAULTS UPON SENIOR SECURITIES</u>	55
<u>ITEM 4.</u>	
<u>MINE SAFETY DISCLOSURES</u>	55
<u>ITEM 5.</u>	
<u>OTHER INFORMATION</u>	55
<u>ITEM 6.</u>	
<u>EXHIBITS</u>	56

Table of Contents

PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PriceSmart, Inc.'s ("PriceSmart," "we" or the "Company") unaudited consolidated balance sheet as of February 28, 2018 and the consolidated balance sheet as of August 31, 2017, the unaudited consolidated statements of income for the three and six months ended February 28, 2018 and 2017, the unaudited consolidated statements of comprehensive income for the three and six months ended February 28, 2018 and 2017, the unaudited consolidated statements of equity for the six months ended February 28, 2018 and 2017, and the unaudited consolidated statements of cash flows for the six months ended February 28, 2018 and 2017, are included herein. Also included herein are the notes to the unaudited consolidated financial statements.

Table of Contents

PRICESMART, INC.

CONSOLIDATED BALANCE SHEETS

(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

	February 28, 2018 (Unaudited)	August 31, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 152,132	\$ 162,434
Short-term restricted cash	365	460
Receivables, net of allowance for doubtful accounts of \$0 and \$7 as of February 28, 2018 and August 31, 2017, respectively	8,194	6,460
Merchandise inventories	314,811	310,946
Prepaid expenses and other current assets	30,115	30,070
Total current assets	505,617	510,370
Long-term restricted cash	3,114	2,818
Property and equipment, net	580,117	557,829
Goodwill	35,473	35,642
Deferred tax assets	10,449	15,412
Other non-current assets (includes \$4,030 and \$2,547 as of February 28, 2018 and August 31, 2017, respectively, for the fair value of derivative instruments)	46,168	44,678
Investment in unconsolidated affiliates	10,786	10,765
Total Assets	\$ 1,191,724	\$ 1,177,514
LIABILITIES AND EQUITY		
Current Liabilities:		
Accounts payable	\$ 253,579	\$ 272,248
Accrued salaries and benefits	18,682	19,151
Deferred membership income	24,255	22,100
Income taxes payable	8,839	5,044
Other accrued expenses	26,449	26,483
Dividends payable	10,652	—
Long-term debt, current portion	14,160	18,358
Total current liabilities	356,616	363,384
Deferred tax liability	1,800	1,812
Long-term portion of deferred rent	9,014	8,914
Long-term income taxes payable, net of current portion	4,147	909
Long-term debt, net of current portion	82,512	87,939
Other long-term liabilities (includes \$670 and \$682 for the fair value of derivative instruments and \$5,688 and \$5,051 for post-employment plans as of February 28, 2018 and August 31, 2017, respectively)	6,401	5,789

Total Liabilities

460,490

468,747

2

Table of Contents

Equity:

Common stock \$0.0001 par value, 45,000,000 shares authorized; 31,310,880 and 31,275,727 shares issued and 30,414,382 and 30,400,742 shares outstanding (net of treasury shares) as of February 28, 2018 and August 31, 2017, respectively	3	3
Additional paid-in capital	427,545	422,395
Tax benefit from stock-based compensation	11,486	11,486
Accumulated other comprehensive loss	(106,250)	(110,059)
Retained earnings	436,207	420,866
Less: treasury stock at cost, 896,498 and 874,985 shares as of February 28, 2018 and August 31, 2017, respectively	(37,757)	(35,924)
Total Equity	731,234	708,767
Total Liabilities and Equity	\$ 1,191,724	\$ 1,177,514

See accompanying notes.

Table of Contents

PRICESMART, INC.

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED—AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

	Three Months Ended		Six Months Ended	
	February 28,	February 28,	February 28,	February 28,
	2018	2017	2018	2017
Revenues:				
Net warehouse club sales	\$ 816,573	\$ 772,273	\$ 1,561,974	\$ 1,488,352
Export sales	9,138	8,172	17,285	18,906
Membership income	12,703	11,833	25,078	23,543
Other income	1,149	1,018	2,298	2,067
Total revenues	839,563	793,296	1,606,635	1,532,868
Operating expenses:				
Cost of goods sold:				
Net warehouse club	699,355	659,802	1,336,591	1,268,292
Export	8,685	7,761	16,434	17,942
Selling, general and administrative:				
Warehouse club operations	71,951	67,784	141,453	133,210
General and administrative	20,258	18,212	39,088	35,014
Pre-opening expenses	81	—	511	(113)
Asset impairment	1,929	—	1,929	—
Loss/(gain) on disposal of assets	40	335	199	742
Total operating expenses	802,299	753,894	1,536,205	1,455,087
Operating income	37,264	39,402	70,430	77,781
Other income (expense):				
Interest income	368	549	768	1,051
Interest expense	(992)	(1,644)	(2,247)	(3,298)
Other income (expense), net	210	915	488	(13)
Total other income (expense)	(414)	(180)	(991)	(2,260)
Income before provision for income taxes and				
income (loss) of unconsolidated affiliates	36,850	39,222	69,439	75,521
Provision for income taxes	(22,707)	(11,989)	(32,822)	(23,426)
Income (loss) of unconsolidated affiliates	5	(14)	21	(7)
Net income	\$ 14,148	\$ 27,219	\$ 36,638	\$ 52,088
Net income per share available for distribution:				
Basic net income per share	\$ 0.47	\$ 0.90	\$ 1.21	\$ 1.72
Diluted net income per share	\$ 0.47	\$ 0.90	\$ 1.21	\$ 1.72
Shares used in per share computations:				

Edgar Filing: PRICESMART INC - Form 10-Q

Basic	30,100	30,004	30,089	29,993
Diluted	30,100	30,008	30,090	29,997
Dividends per share	\$ 0.70	\$ 0.70	\$ 0.70	\$ 0.70

See accompanying notes.

4

Table of Contents

PRICESMART, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Three Months Ended		Six Months Ended	
	February 28,	February 28,	February 28,	February 28,
	2018	2017	2018	2017
Net income	\$ 14,148	\$ 27,219	\$ 36,638	\$ 52,088
Other Comprehensive Income, net of tax:				
Foreign currency translation adjustments (1)	\$ 4,339	\$ 9,237	\$ 2,313	\$ (1,629)
Defined benefit pension plan:				
Amortization of prior service cost and actuarial gains included in net periodic pensions cost	29	(7)	59	(14)
Total defined benefit pension plan	29	(7)	59	(14)
Derivative instruments: (2)				
Unrealized gains/(losses) on change in fair value of interest rate swaps	850	291	1,437	783
Total derivative instruments	850	291	1,437	783
Other comprehensive income (loss)	5,218	9,521	3,809	(860)
Comprehensive income	\$ 19,366	\$ 36,740	\$ 40,447	\$ 51,228

(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 7 - Derivative Instruments and Hedging Activities.

See accompanying notes.

Table of Contents

PRICESMART, INC.

CONSOLIDATED STATEMENTS OF EQUITY

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Common Stock Shares	Amount	Additional Paid-in Capital	Tax Benefit From Stock Based Compensation	Accumulated Other Comprehensive Income(Loss)	Retained Earnings	Treasury Stock Shares	Amount	Total Equity
Balance at August 31, 2016	31,238	\$ 3	\$ 412,369	\$ 11,321	\$ (103,951)	\$ 351,060	836	\$ (32,731)	\$ 638,071
Purchase of treasury stock	—	—	—	—	—	—	24	(1,941)	(1,941)
Issuance of restricted stock award	23	—	—	—	—	—	—	—	—
Forfeiture of restricted stock awards	(2)	—	—	—	—	—	—	—	—
Exercise of stock options	5	—	229	—	—	—	—	—	229
Stock-based compensation	—	—	5,178	213	—	—	—	—	5,391
Dividend paid to stockholders	—	—	—	—	—	(10,641)	—	—	(10,641)
Dividend payable to stockholders	—	—	—	—	—	(10,643)	—	—	(10,643)
Net income	—	—	—	—	—	52,088	—	—	52,088
Other comprehensive income (loss)	—	—	—	—	(860)	—	—	—	(860)
Balance at February 28, 2017	31,264	\$ 3	\$ 417,776	\$ 11,534	\$ (104,811)	\$ 381,864	860	\$ (34,672)	\$ 671,694
Balance at August 31, 2017	31,276	\$ 3	\$ 422,395	\$ 11,486	\$ (110,059)	\$ 420,866	875	\$ (35,924)	\$ 708,767

Edgar Filing: PRICESMART INC - Form 10-Q

Purchase of treasury stock	—	—	—	—	—	—	21	(1,833)	(1,833)
Issuance of restricted stock award	38	—	—	—	—	—	—	—	—
Forfeiture of restricted stock awards	(7)	—	—	—	—	—	—	—	—
Exercise of stock options	4	—	269	—	—	—	—	—	269
Stock-based compensation	—	—	4,881	—	—	—	—	—	4,881
Dividend paid to stockholders	—	—	—	—	—	(10,645)	—	—	(10,645)
Dividend payable to stockholders	—	—	—	—	—	(10,652)	—	—	(10,652)
Net income	—	—	—	—	—	36,638	—	—	36,638
Other comprehensive income (loss)	—	—	—	—	3,809	—	—	—	3,809
Balance at February 28, 2018	31,311	\$ 3	\$ 427,545	\$ 11,486	\$ (106,250)	\$ 436,207	896	\$ (37,757)	\$ 731,234

See accompanying notes.

Table of Contents

PRICESMART, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Six Months Ended	
	February 28, 2018	February 28, 2017
Operating Activities:		
Net income	\$ 36,638	\$ 52,088
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	24,812	22,562
Allowance for doubtful accounts	(7)	—
Asset impairment and closure costs	1,929	—
(Gain)/loss on sale of property and equipment	199	742
Deferred income taxes	6,668	(1,412)
Equity in (gains) losses of unconsolidated affiliates	(21)	7
Stock-based compensation	4,881	5,178
Change in operating assets and liabilities:		
Receivables, prepaid expenses and other current assets, non-current assets, accrued salaries and benefits, deferred membership income and other accruals	5,914	717
Merchandise inventories	(3,865)	(14,077)
Accounts payable	(18,069)	(817)
Net cash provided by (used in) operating activities	59,079	64,988
Investing Activities:		
Additions to property and equipment	(46,233)	(87,020)
Deposits for land purchase option agreements	—	(300)
Proceeds from disposal of property and equipment	54	181
Net cash provided by (used in) investing activities	(46,179)	(87,139)
Financing Activities:		
Proceeds from long-term bank borrowings	13,500	35,700
Repayment of long-term bank borrowings	(23,150)	(7,231)
Proceeds from short-term bank borrowings	57,248	—
Repayment of short-term bank borrowings	(57,248)	(10,011)
Cash dividend payments	(10,645)	(10,641)
Purchase of treasury stock for tax withholding on stock compensation	(1,833)	(1,941)
Proceeds from exercise of stock options	269	229
Net cash provided by (used in) financing activities	(21,859)	6,105
Effect of exchange rate changes on cash and cash equivalents and restricted cash	(1,142)	(1,155)
Net increase (decrease) in cash, cash equivalents	(10,101)	(17,201)
Cash, cash equivalents and restricted cash at beginning of period	165,712	202,716
Cash, cash equivalents and restricted cash at end of period	\$ 155,611	\$ 185,515

Supplemental disclosure of cash flow information:
Dividends declared but not paid

\$ 10,652 \$ 10,643

7

Table of Contents

The following table provides a breakdown of cash and cash equivalents, and restricted cash reported within the statement of cash flows:

	Six Months Ended	
	February 28,	February 28,
	2018	2017
Cash and cash equivalents	\$ 152,132	\$ 181,990
Short-term restricted cash	365	816
Long-term restricted cash	3,114	2,709
Total cash and cash equivalents, and restricted cash shown in the statement of cash flows	\$ 155,611	\$ 185,515

See accompanying notes.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

February 28, 2018

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 February 28, 2018, the Company had 40 consolidated warehouse clubs in operation in 12 countries and one U.S. territory (seven each in Colombia and Costa Rica; five in Panama; four in Trinidad; three each in Guatemala, the Dominican Republic and Honduras; two each 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). The Company opened a new warehouse club in Santa Ana, Costa Rica in October 2017, bringing the total warehouse clubs operating in Costa Rica to seven. In June 2017, the Company acquired land in Santo Domingo, Dominican Republic. The Company is currently building a warehouse club on this site and expects to open in May of 2018. This will bring the number of PriceSmart warehouse clubs operating in Dominican Republic to four.

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, 2017 (the "2017 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.

Reclassifications to consolidated statement of cash flows recorded during fiscal year 2018 for fiscal year 2017 – Accounting Standards Update (ASU) 2016-18 - The amendments in ASU 2016-18 require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. Thus, amounts generally described as restricted cash and restricted cash

equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and the end-of-period total amounts set forth on the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2017 and interim periods within those fiscal years and will be applied using a retrospective transition method to each period presented. The Company early adopted this ASU as of August 31, 2017. The adoption of this ASU impacted the presentation of cash flows with inclusion of restricted cash flows for each of the presented periods.

Additionally, the Company adopted Accounting Standards Update (ASU) 2016-09, effective as of September 1, 2017. The Company made certain elections and changes to account for share-based payments to employees according to the new standard as follows:

Accounting for policy election to recognize forfeitures as they occur – The Company made a policy election to recognize forfeitures as they occur. Accordingly, the Company applied the modified retrospective transition method, with a cumulative-effect adjustment to prior-year (August 31, 2017) retained earnings. Therefore, the Company recorded an increase to prior-year retained earnings and a decrease to additional paid-in capital of \$367,000 in each case. The table below summarizes the change to the prior year balance sheet (in thousands):

	August 31, 2017		August 31, 2017
	balance sheet line item		balance sheet line item
	as previously reported	Amount reclassified	as currently reported
Retained earnings	\$ 420,499	\$ 367	\$ 420,866
Additional paid-in capital	\$ 422,762	\$ (367)	\$ 422,395

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Presentation of excess tax benefits and employee taxes paid on the statement of cash flows

- According to ASU 2016-09, the cash paid to a tax authority when shares are withheld to satisfy the employer's statutory income tax withholding obligation should be classified as a financing activity on the statement of cash flows, and the full retrospective transition method should be applied. The Company already classifies cash paid for tax withholdings as a financing activity; thus, the adoption did not change the Company's classification for this activity. However, the Company has changed the naming convention from "Purchase of treasury stock" to "Purchase of treasury stock for tax withholding on stock compensation" in the statement of cash flows.
- Furthermore, the new standard requires the Company to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity. The Company has adopted this change, retrospectively, which resulted in \$213,000 being reclassified from a financing activity to an operating activity for the six months ended February 28, 2017.

NOTE 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 February 28, 2018, all of the Company's subsidiaries were wholly owned. Additionally, the Company's ownership interest in real estate development joint ventures as of February 28, 2018 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.

The Company determines whether any of the joint ventures in which it has made investments is a Variable Interest Entity (“VIE”) at the start of each new venture and if a reconsideration event has occurred. At this time, the Company also considers whether it must consolidate a VIE and/or disclose information about its involvement in a VIE. A reporting entity must consolidate a VIE if that reporting entity has a variable interest (or combination of variable interests) that will absorb a majority of the VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. A reporting entity must consider the rights and obligations conveyed by its variable interests and the relationship of its variable interests with variable interests held by other parties to determine whether its variable interests will absorb a majority of a VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. The reporting entity that consolidates a VIE is called the primary beneficiary of that VIE.

Due to the nature of the joint ventures and the continued commitments for additional financing, the Company determined these joint ventures are VIEs. Since all rights, obligations and the power to direct the activities of a VIE that most significantly impact the VIE's economic performance is shared equally by both parties within each joint venture, 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. Under the equity method, the Company's investments in unconsolidated affiliates are initially recorded as an investment in the stock of an investee at cost and are adjusted for the carrying amount of the investment to recognize the investor's share of the earnings or losses of the investee after the date of the initial investment.

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.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 most countries where the Company operates, the governments have implemented additional collection procedures, such as requiring credit and debit card processors to remit a portion of sales processed via credit and debit 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, as of August 31, 2016, there were three countries that lacked a clearly defined process. During the third and fourth quarters of fiscal year 2017, two of these countries clarified the refund mechanism, which we are currently pursuing. The Company, together with its tax and legal advisers, is currently seeking clarification in court in the remaining country without a clearly defined process and expects to prevail. The balance of the VAT receivable in the country with undefined refund mechanisms was approximately \$633,000 and \$1.2 million as of February 28, 2018 and August 31, 2017, respectively. In another country in which the Company operates warehouse clubs, a new minimum income tax mechanism took effect in fiscal year 2015, 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 to offset this excess income tax against other taxes. As of February 28, 2018 and August 31, 2017, the Company had deferred tax assets of approximately \$2.2 million and \$2.0 million in this country, respectively. Also, the Company had an income tax receivable balance of \$5.3 million and \$4.3 million as of February 28, 2018 and August 31, 2017, respectively, related to excess payments from fiscal years 2015 to 2017. 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 ultimately succeed in its refund requests, related appeals and/or court challenge on these matters.

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 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 Company does not currently have any allowances provided against VAT and income tax receivables.

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

	February 28, 2018	August 31, 2017
Prepaid expenses and other current assets	\$ 9,537	\$ 6,650
Other non-current assets	19,880	24,904
Total amount of VAT receivables reported	\$ 29,417	\$ 31,554

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

	February 28, 2018	August 31, 2017
Prepaid expenses and other current assets	\$ 4,096	\$ 6,403
Other non-current assets	15,329	10,492
Total amount of Income tax receivables reported	\$ 19,425	\$ 16,895

Merchandise Inventories – Merchandise inventories, which include merchandise for resale, are valued at the lower of cost (average cost) or net realizable value. 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.

Stock Based Compensation – The Company utilizes three types of equity awards: stock options (“options”), restricted stock awards (“RSAs”) and restricted stock units (“RSUs”). The Company adopted ASU 2016-09 – Compensation - Stock Compensation (Topic 718) on September 1, 2017, see Note 1 – Company Overview and Basis of Presentation for more information on the implementation. 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. 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. As a result of adoption of ASU 2016-09, the Company currently accounts for actual forfeitures as they occur. The Company records the tax savings resulting from tax deductions in excess of expense for stock-based compensation and the tax deficiency resulting from stock-based compensation in excess of the related tax deduction as income tax expense or benefit, based on ASU 2016-09. In addition, the Company reflects the tax savings (deficiency) resulting from the taxation of stock-based compensation as an operating cash flow in its consolidated statement of cash flows.

RSAs are outstanding shares of common stock and have the same cash dividend and voting rights as other 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.

Exit or Disposal Cost Obligations – In January 2017, the Company purchased a distribution center in Medley, Miami-Dade County, Florida. The Company transferred its Miami dry distribution center activities that were previously in a leased facility to the new facility during the third quarter of fiscal year 2017. As part of this transaction, the Company has recorded an exit obligation related to the lease of the previous distribution center. The obligation consists of the costs associated with the exit or disposal activity measured initially at its fair value as of May 1, 2017, the date on which the obligation was incurred. These costs are primarily comprised of the costs to terminate the operating lease and other associated costs, including costs to consolidate or close facilities, net of any potential sub-lease income the Company could receive during the remaining lease term. In periods subsequent to initial measurement, changes to the exit obligation, including any changes resulting from a revision to either the timing or the amount of estimated cash flows over the remaining lease period, is measured using the credit-adjusted risk-free rate that was used to measure the initial obligation. During the third quarter of fiscal year 2017, the Company initially recorded an obligation related to this exit activity for approximately \$496,000 within other long-term liabilities. The Company's exit obligation recorded as of August 31, 2017 was approximately \$57,000. The Company's exit obligation recorded as of February 28, 2018 was approximately \$43,000. Exit costs of approximately \$1.4 million were recorded to net warehouse club cost of goods sold for the twelve months ended August 31, 2017. Exit costs of approximately \$623,000 were recorded to net warehouse club cost of goods sold for the six months ended February 28, 2018. Subsequent to the balance sheet date the Company entered into a sub-lease agreement for approximately half of the facility, which will reduce the Company's expenses going forward.

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 obligor in a transaction between such parties, not the amount that would be paid to settle the liability with the creditor.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 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, consisted of 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 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 Company's current and long-term financial assets and liabilities have fair values that approximate their carrying values. The Company's long-term financial liabilities consist of long-term debt, which is recorded on the balance sheet at issuance price and adjusted for any applicable unamortized discounts or premiums and debt issuance costs. There have been no significant changes in fair market value of the Company's current and long-term financial assets, and there have been no material changes to the valuation techniques utilized in the fair value measurement of assets and liabilities as disclosed in the Company's 2017 Form 10-K.

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. 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. The Company did not change valuation techniques utilized in the fair value measurement of assets and liabilities presented on the Company's consolidated balance sheets 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 entire gain or loss 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. Amounts recorded in accumulated other comprehensive loss are released to earnings in the same period that the hedged transaction impacts consolidated earnings. See Note 7 - Derivative Instruments and Hedging Activities for information on the fair value of interest rate swaps and cross-currency interest rate swaps as of February 28, 2018 and August 31, 2017.

Fair Value Instruments. The Company is exposed to foreign-currency exchange rate fluctuations in the normal course of business. This includes exposure to foreign-currency exchange rate fluctuations on U.S. dollar denominated liabilities within the Company's 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 flows 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 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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

and are limited to less than one year in duration. See Note 7 - Derivative Instruments and Hedging Activities for information on the fair value of open, unsettled forward foreign-exchange contracts as of February 28, 2018 and August 31, 2017.

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.

Self-Insurance – As of October 1, 2017, PriceSmart, Inc. became self-insured for its employee medical health benefits and in doing so the Company has assumed the financial risk for providing health care benefits to its employees. The Company contracted with Cigna Health and Life Insurance Company (“CHLIC”), a third party administrator, to process claims on its behalf under an Administrative Services Only (ASO) agreement. The Company has elected to purchase “Stop Loss Insurance” to cover the risk in excess of certain dollar limits. The Company establishes an estimated accrual for its insurance program based on available comparable claims data, trends and projected ultimate costs of claims. This accrual is based on estimates prepared with the assistance of outside actuaries and the ultimate cost of these claims may vary from initial estimates and established accrual. The actuaries periodically update their estimates and the Company records such adjustments in the period in which such determination is made. The accrued obligation for this self-insurance program is included in “Accrued salaries and benefits” in the consolidated balance sheets and is \$381,000 as of February 28, 2018.

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. The Company recorded an impairment charge of approximately \$1.9 million for the three and six months ended February 28, 2018 related to the write off of internally developed software for e-commerce due to the Company's acquisition of Aeropost, Inc. (see Note 9 – Subsequent Events) and its digital e-commerce platform.

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 and six months ended February 28, 2018 and 2017 (in thousands):

	Three Months Ended		Six Months Ended	
	February 28,	February 28,	February 28,	February 28,
	2018	2017	2018	2017
Currency gain (loss)	\$ 210	\$ 915	\$ 488	\$ (13)

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Recent Accounting Pronouncements – Not Yet Adopted

FASB ASC 220 ASU 2018-02 - Income Statement—Reporting Comprehensive Income (Topic 220)—Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

In February 2018, the FASB issued Accounting Standards Update (ASU) No. 2018-02, Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which helps organizations reclassify certain stranded income tax effects in accumulated other comprehensive income resulting from the Tax Cuts and Jobs Act of 2017 (“tax reform”), enacted on December 22, 2017. ASU No. 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from tax reform. Additionally, ASU No. 2018-02 requires financial statement preparers to disclose (1) a description of their accounting policy for releasing income tax effects from accumulated other comprehensive income, (2) whether they elect to reclassify the stranded income tax effects from the tax reform, and (3) information about other income tax effects related to the application of the tax reform that are reclassified from accumulated other comprehensive income to retained earnings, if any. The amendments in this ASU are effective for annual periods beginning after December 15, 2018 and interim periods within those annual periods. Early adoption is permitted. The Company will evaluate the impact adoption of this guidance may have on the Company’s consolidated financial statements.

FASB ASC 715 ASU 2017-09 - Compensation—Stock Compensation (Topic 718)—Scope of Modification Accounting

In May 2017, the FASB issued Accounting Standards Update (ASU) No. 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting, which seeks to provide clarity, reduce diversity in practice, and reduce cost and complexity when applying the guidance in Topic 718, Compensation—Stock Compensation, regarding a change to the terms or conditions of a share-based payment award. This ASU provides guidance concerning which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. Specifically, an entity is to account for the effects of a modification, unless all of the following are satisfied: (1) the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified; (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3) the classification of the modified award as an equity instrument or as a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments in this ASU are effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. Early adoption is permitted. The Company will evaluate the impact adoption of this

guidance may have on the Company's consolidated financial statements.

FASB ASC 715 ASU 2017-07- Compensation—Retirement Benefits (Topic 715) — Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

In March 2017, the FASB issued ASU No. 2017-07, Compensation—Retirement Benefits (Topic 715) — Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This ASU is designed to improve guidance related to the presentation of defined benefit costs in the income statement. In particular, ASU 2017-07 requires that an employer report the service cost component in the same line item(s) as other compensation costs arising from services rendered by the pertinent employees during the period. The amendments in this ASU are effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. Early adoption is permitted. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

FASB ASC 350 ASU 2017-04- Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment

In January 2017, the FASB issued Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This ASU simplifies the manner in which an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Under the amendments in this ASU, an entity should (1) perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, and (2) recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, with the understanding that the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit.

Additionally, ASU 2017-04 requires any reporting unit with a zero or negative carrying amount to perform Step 2 of the goodwill impairment test. The amendments in this ASU are effective for annual periods beginning after December 15, 2019. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

FASB ASC 740 ASU 2016-16- Income Taxes (Topic 740)—Intra-Entity Transfers of Assets Other Than Inventory

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740)—Intra-Entity Transfers of Assets Other than Inventory. Currently, U.S. GAAP prohibits recognizing current and deferred income tax consequences for an intra-entity asset transfer until the asset has been sold to an outside party. ASU 2016-16 states that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs.

The amendments in this ASU are effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. Early adoption is permitted. The amendments should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

FASB ASC 842 ASU 2016-02 -Leases (Topic 842): Amendments to the FASB Accounting Standards Codification

In February 2016, the FASB issued guidance codified in ASC 842, Leases, which supersedes the guidance in ASC 840, Leases. ASC 842 will be effective for the Company on September 1, 2019, and the Company expects to apply the transition practical expedients allowed by the standard. Note 11 – “Leases” provides details on the Company's current lease arrangements. While the Company continues to evaluate the provisions of ASC 842 to determine how it will be affected, the primary effect will be to require recording right-of-use assets and corresponding lease obligations for current operating leases. The Company expects the adoption of this guidance to have a material impact on the Company's consolidated balance sheets, but not on the consolidated statements of income or cash flows.

FASB ASC 606 ASU 2014-09 - Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (FASB) issued new guidance on the recognition of revenue from contracts with customers. The guidance combines the requirements for reporting revenue and requires disclosures sufficient to describe the nature, amount, timing, and uncertainty of revenue and cash flows arising from these contracts. Transition is permitted either retrospectively or as a cumulative effect adjustment as of the date of adoption. The new standard is effective for fiscal years and interim periods within those years beginning after

December 15, 2017. The Company plans to adopt this guidance at the beginning of its first quarter of fiscal year 2019. The Company is evaluating the impact of the adoption of this guidance on all of its sources of revenue and the resulting effect it will have on the Company's consolidated financial statements and related disclosures.

Recent Accounting Pronouncements Adopted

FASB ASC 815 ASU 2017-12 Derivatives and Hedging - Targeted Improvements to Accounting for Hedging Activities

The FASB has issued Accounting Standards Update (ASU) No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, which aims to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. The amendments in this ASU are intended to better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To satisfy that objective, the amendments expand and refine hedge accounting for both non-financial and financial risk components, and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements.

Additionally, the amendments (1) permit hedge accounting for risk components in hedging relationships involving non-financial risk and interest rate risk; (2) change the guidance for designating fair value hedges of interest rate risk and for measuring the change in fair value of the hedged item in fair value hedges of interest rate risk; (3) continue to allow an entity to exclude option premiums and forward points from the assessment of hedge effectiveness; and (4) permit an entity to exclude the portion of the change in fair value of a currency swap that is attributable to a cross-currency basis spread from the assessment of hedge effectiveness. The amendments in this ASU are effective for annual periods beginning after December 15, 2018 and interim periods within those annual periods, with early adoption allowed. The Company adopted this guidance during the second quarter of fiscal year 2018. Adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

FASB ASC 718 ASU 2016-09 - Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting

In March 2016, the FASB issued new guidance on stock compensation intended to simplify accounting for share-based payment transactions. The guidance will change accounting for income taxes, forfeitures and minimum statutory tax withholding requirements. The new standard is effective for fiscal years and interim periods within those years beginning after December 15, 2016, with early adoption permitted. The Company adopted this guidance on September 1, 2017.

- The Company determined that the adoption of this guidance did not have a material effect on the result of operations and the calculation of earnings per share. The Company has used the two-step method for the diluted net income per share calculation over the last several years.
- The adoption of this guidance and the amendments related to the presentation of employee taxes paid on the statement of cash flows did not have a material effect on the consolidated statements of cash flows.
- The adoption of this guidance and the amendments related to the timing of when excess tax benefits are recognized, the effect of minimum statutory withholding requirements, forfeitures, and intrinsic value and the adoption of this methodology using the modified retrospective transition method resulted in the Company electing to eliminate the recording of the forfeiture rate on the expense recorded. The elimination of the forfeiture rate required recording a cumulative-effect adjustment by increasing retained earnings and reducing Additional Paid in Capital, at the beginning of the year of adoption, which was September 1, 2017, for the service periods already incurred for unvested shares.

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. This amendment applies to entities, like the Company, that measure inventory value using the average cost method. The amendments in this ASU 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. The Company adopted this guidance on September 1, 2017. Adoption of this guidance did not have a material effect on the Company's consolidated financial

statements.

FASB ASC 230 ASU 2016-18- Statement of Cash Flows (Topic 230)—Restricted Cash

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230)—Restricted Cash. This ASU addresses the diversity in practice that exists regarding the classification and the presentation of changes in restricted cash on the statement of cash flows.

The amendments in ASU No. 2016-18 require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. Thus, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and the end-of-period total amounts set forth on the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2017 and interim periods within those fiscal years and will be applied using a retrospective transition method to each period presented. The Company early adopted this ASU as of August 31, 2017. The adoption of this ASU impacted the presentation of cash flows with inclusion of restricted cash flows for each of the presented periods.

FASB ASC 230 ASU 2016-15- Statement of Cash Flows (Topic 230)—Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force)

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU addresses stakeholders' concerns regarding diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and Other Topics. In particular, ASU No. 2016-15 addresses eight specific cash flow issues in an effort to reduce this diversity in practice: (1) debt prepayment or debt extinguishment costs; (2) settlement of zero-coupon bonds; (3) contingent consideration payments made after a business combination; (4) proceeds from the settlement of insurance claims; (5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (6) distributions received from equity method investees; (7) beneficial interests in securitization transactions; and (8) separately identifiable cash flows and application of the predominance principle.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The amendments in this ASU are effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. Early adoption is permitted. The amendments in this ASU should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The Company early adopted this guidance on December 1, 2017. Adoption of this guidance did not have an effect on the Company's consolidated financial statements.

NOTE 3 – 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 issued pursuant to 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 and six months ended February 28, 2018 and 2017 (in thousands, except per share amounts):

Three Months Ended	Six Months Ended
February 28,	February 28,

Edgar Filing: PRICESMART INC - Form 10-Q

	2018	2017	2018	2017
Net income	\$ 14,148	\$ 27,219	\$ 36,638	\$ 52,088
Less: Allocation of income to unvested stockholders	—	(345)	(398)	(758)
Net earnings available to common stockholders	\$ 14,148	\$ 26,874	\$ 36,240	\$ 51,330
Basic weighted average shares outstanding	30,100	30,004	30,089	29,993
Add dilutive effect of stock options (two-class method)	—	4	1	4
Diluted average shares outstanding	30,100	30,008	30,090	29,997
Basic net income per share	\$ 0.47	\$ 0.90	\$ 1.21	\$ 1.72
Diluted net income per share	\$ 0.47	\$ 0.90	\$ 1.21	\$ 1.72

NOTE 4 – STOCKHOLDERS’ EQUITY

Dividends

The following table summarizes the dividends declared and paid during fiscal year 2018 and 2017 (amounts are per share).

Declared	Amount	First Payment			Amount	Second Payment			Amount
		Record Date	Date Paid	Date Payable		Record Date	Date Paid	Date Payable	
1/24/2018	\$ 0.70	2/14/2018	2/28/2018	N/A	\$ 0.35	8/15/2018	N/A	8/31/2018	\$ 0.35
2/1/2017	\$ 0.70	2/15/2017	2/28/2017	N/A	\$ 0.35	8/15/2017	8/31/2017	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.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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):

	Six Months Ended February 28, 2018			
	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments	Total
Beginning balance, September 1, 2017	\$ (108,539)	\$ (442)	\$ (1,078)	\$ (110,059)
Other comprehensive income (loss)	2,313	59	1,437	(1) 3,809
Ending balance, February 28, 2018	\$ (106,226)	\$ (383)	\$ 359	\$ (106,250)

	Six Months Ended February 28, 2017			
	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments	Total
Beginning balance, September 1, 2016	\$ (102,242)	\$ (315)	\$ (1,394)	\$ (103,951)
Other comprehensive income (loss)	(1,629)	—	783	(1) (846)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(14)	(2)	(14)
Ending balance, February 28, 2017	\$ (103,871)	\$ (329)	\$ (611)	\$ (104,811)

Twelve Months Ended August 31, 2017

Total

Edgar Filing: PRICESMART INC - Form 10-Q

	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments	
Beginning balance, September 1, 2016	\$ (102,242)	\$ (315)	\$ (1,394)	\$ (103,951)
Other comprehensive income (loss)	(6,297)	(166)	316 (1)	(6,147)
Amounts reclassified from accumulated other comprehensive income (loss)	—	39 (2)	—	39
Ending balance, August 31, 2017	\$ (108,539)	\$ (442)	\$ (1,078)	\$ (110,059)

(1) See Note 7 - 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.

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):

	February 28, 2018	August 31, 2017
Retained earnings not available for distribution	\$ 6,708	\$ 6,459

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 5 – 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 related to the Company's operations 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 results of operations for a particular quarter or fiscal year could be impacted by changes in circumstances relating to such matters.

Taxes

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 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. There were no material changes in the Company's uncertain income tax positions as of February 28, 2018 and August 31, 2017.

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 February 28, 2018 and August 31, 2017, the Company has recorded within other accrued expenses a total of \$3.1 million and \$3.4 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.

The Company has various appeals pending before tax courts in its subsidiaries' jurisdictions. Any possible settlement could increase or decrease earnings but is not expected to be significant. Audit outcomes and the timing of audit settlements are subject to significant uncertainty. One of the Company's subsidiaries received assessments claiming \$2.7 million of taxes, penalties and interest related to withholding taxes on certain charges for services rendered by the Company. In addition, this subsidiary received assessments totaling \$5.5 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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

has not recorded a provision for these assessments. However, the Company had to submit these amounts as advance payments to the government while it appeals.

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 to offset this excess income tax against other taxes. As of February 28, 2018 and August 31, 2017, the Company had deferred tax assets of approximately \$2.2 million and \$2.0 million in this country, respectively. Also, the Company had an income tax receivable balance of \$5.3 million and \$4.3 million as of February 28, 2018 and August 31, 2017, respectively, related to excess payments from fiscal years 2015 to 2017. 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 historically provided for U.S. deferred taxes on cumulative non-U.S. undistributed earnings as such earnings have been deemed by the Company to be indefinitely reinvested. However, subsequent to new United States tax legislation, PriceSmart made a provisional estimate of the one-time transitional repatriation tax on unremitted foreign earnings (“Transition Tax”) of approximately \$13.4 million, which was recorded as an income tax expense in the second quarter of fiscal 2018. The cash amounts due for the Transition Tax will be offset by foreign tax credits expected to exceed \$10.0 million, with the remainder to be paid in equal installments over 8 years.

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):

Open

Years ended February 28,	Locations(1)
2019	\$ 12,467
2020	11,904
2021	10,607
2022	9,333
2023	9,344
Thereafter	115,579
Total	\$ 169,234 (2)

- (1) Operating lease obligations have been reduced by approximately \$818,000 to reflect sub-lease income. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.
- (2) Future minimum lease payments include \$2.8 million of lease payment obligations for the prior leased Miami distribution center. For the purposes of calculating the minimum lease payments, no reduction was considered for the potential sub-lease income the Company could receive during the remaining lease term for unexecuted subleases. However, projected income for any executed sub-leases would be used to reduce the amount reported as minimum lease payments. Potential sub-lease income was considered, however, for the purposes of calculating the exit obligation of \$43,000 recorded on the balance sheet as of February 28, 2018.

In January 2017, the Company purchased a distribution center in Medley, Miami-Dade County, Florida. The Company transferred its Miami dry distribution center activities that were previously in the leased facility to the new facility during the third quarter of fiscal year 2017. Some portions of the vacated previously leased space were subleased (and subsequently returned to the landlord) while the remainder remains available for sublease. As part of the agreement to return one of the subleases to the landlord, the Company was required to execute and deliver to the landlord of the leased facility a letter of credit (“LOC”) in the amount of \$500,000 which entitles the landlord to draw on the LOC if certain conditions occur related to nonpayment by the new tenant. The balance of this LOC decreases at an annual rate of \$125,000 starting in August 2018. Although this agreement is considered a guarantee, in measuring the fair value, the Company considers the risk and probability of default by the third party tenant as not likely nor probable based on the Company’s review of the third party tenant’s financial position as well as the third party’s considerable capital investment into the leased facility. Therefore, the Company has not recorded a liability for this guarantee.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company is also committed to non-cancelable construction services obligations for various warehouse club developments and expansions. As of February 28, 2018 and August 31, 2017, the Company had approximately \$1.1 million and \$7.9 million, respectively, in contractual obligations for construction services not yet rendered.

The Company has entered into land purchase option agreements that have not been recorded as commitments, for which the Company has recorded within restricted cash and deposits as of February 28, 2018 and August 31, 2017 approximately \$600,000. The land purchase option agreements can be canceled at the sole option of the Company, with the deposits being fully refundable until all permits are issued. The Company does not have a timetable of when or if it will exercise these land purchase options, due to the uncertainty related to the completion of the Company's due diligence reviews. The Company's due diligence reviews include evaluations of the legal status of each 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 agreements are exercised, the cash use would be approximately \$20.8 million.

The table below summarizes the Company's interest in real estate joint ventures, commitments to additional future investments and the Company's maximum exposure to loss as a result of its involvement in these joint venture as of February 28, 2018 (in thousands):

Entity	% Ownership	Initial Investment	Additional Investments	Net (Loss)/Income Inception to Date	Company's Variable Interest in Entity	Commitment to Future Additional Investments(1)	Company's Maximum Exposure to Loss in Entity(2)
GolfPark Plaza, S.A.	50 %	\$ 4,616	\$ 2,402	\$ 296	\$ 7,314	\$ 99	\$ 7,413
Price Plaza Alajuela, S.A.	50 %	2,193	1,236	43	3,472	785	4,257
Total		\$ 6,809	\$ 3,638	\$ 339	\$ 10,786	\$ 884	\$ 11,670

(1) The parties intend to seek alternate financing for the project, which could reduce the amount of investments each party would be required to provide. The parties may mutually agree on changes to the project, which could increase or decrease the amount of contributions each party is required to provide.

- (2) The maximum exposure is determined by adding the Company's variable interest in the entity and any explicit or implicit arrangements that could require the Company to provide additional financial support.

The Company contracts for distribution center services in Mexico. The contract for this distribution center's services expires on August 31, 2020, 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 are approximately \$414,000.

The Company contracts for off-site data recovery services as part of its disaster recovery plan. The contract for these data recovery services expires on November 30, 2019. Future minimum service commitments related to this contract are approximately \$280,000 and \$372,000 for 12-month periods ending February 28, 2019 and for the remaining nine-month period ending November 30, 2019, respectively.

NOTE 6 – DEBT

Short-term borrowings consist of lines of credit that are secured by certain assets of the Company and its subsidiaries, which, in some cases, are guaranteed by the Company. The following table summarizes the balances of total facilities, facilities used and facilities available (in thousands):

	Total Amount of Facilities	Facilities Used Short-term Borrowings	Letters Credit Facilities Available	Weighted average interest rate		
February 28, 2018	\$ 69,000	\$ —	\$ 527	\$ 68,473	—	%
August 31, 2017	\$ 69,000	\$ —	\$ 966	\$ 68,034	—	%

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

As of February 28, 2018 and August 31, 2017, the Company had approximately \$40.0 million of short-term facilities in the U.S. that require compliance with certain quarterly financial covenants. As of February 28, 2018 and August 31, 2017, the Company was in compliance with respect to these covenants. Each of the facilities expires annually and is normally renewed.

The following table provides the changes in long-term debt for the six months ended February 28, 2018:

(Amounts in thousands)	Current portion of long-term debt	Long-term debt (net of current portion)	Total
Balances as of August 31, 2017	\$ 18,358	\$ 87,939	\$ 106,297 (1)
Proceeds from long-term debt incurred during the period:			
Honduras subsidiary	1,350	12,150	13,500
Repayments of long-term debt:			
Repayment of loan by Honduras subsidiary with Scotiabank	(600)	(850)	(1,450)
Repayment of loans by Honduras subsidiary with Citibank	(1,850)	(6,063)	(7,913)
Repayment of loan by Trinidad subsidiary	(1,500)	(3,000)	(4,500)
Regularly scheduled loan payments	(1,731)	(7,556)	(9,287)
Translation adjustments on foreign-currency debt of subsidiaries whose functional currency is not the U.S. dollar (2)	133	(108)	25
Balances as of February 28, 2018	\$ 14,160	\$ 82,512	\$ 96,672 (3)

- (1) The carrying amount of non-cash assets assigned as collateral for these loans was \$128.4 million. No cash assets were assigned as collateral for these loans.
- (2) These foreign currency translation adjustments are recorded within Other comprehensive income.
- (3) The carrying amount of non-cash assets assigned as collateral for these loans was \$118.0 million. No cash assets were assigned as collateral for these loans.

In February 2018, the Company's Honduras subsidiary refinanced its portfolio of loans with Citibank. The original notional amount of this portfolio of loans was \$13.5 million, which the Company drew down in fiscal 2015. There

was approximately \$7.9 million of remaining principal outstanding at the time of the refinancing. Under the refinancing agreement, the portfolio of loans was combined into one loan and the notional amount of the loan increased back to the original \$13.5 million, with the interest rate set at the 90 day LIBOR rate plus 3.0%. In conjunction with the refinancing of these loans, the Company's Honduras subsidiary drew down the additional \$5.6 million notional amount during February 2018. In addition, the Company's Honduras subsidiary entered into a cross-currency interest rate swap with Citibank whereby the Company's subsidiary will pay Honduras Lempiras at a fixed interest rate of 9.75%.

In January 2018, the Company's Honduras subsidiary paid off the outstanding principal balance of U.S. \$1.5 million on a loan agreement entered into with Scotiabank.

In August 2017, the Company's Panama subsidiary paid off the outstanding principal balance of U.S. \$13.3 million on a loan agreement entered into with Scotiabank. The Company's subsidiary also settled the interest rate swap that it had entered into with Scotiabank related to this loan.

On March 31, 2017, the Company's Trinidad subsidiary entered into a loan agreement with Citibank, N.A. The agreement provides for a \$12.0 million loan to be repaid in eight quarterly principal payments plus interest. The interest rate is set at the 90 day LIBOR rate plus 3%. The loan was funded on March 31, 2017. As of February 28, 2018, Company's Trinidad subsidiary has repaid \$4.5 million on this loan in addition of regularly scheduled loan payments. As of February 28, 2018, the remaining balance on this loan was \$3.0 million.

In January 2017, the Company finalized its acquisition of a distribution center in Medley, Miami-Dade County, Florida for a total purchase price of approximately \$46.0 million. The Company transferred its Miami distribution center activities previously located in leased facilities to the new distribution center during the third quarter of fiscal year 2017. To finance the acquisition of this property, the Company entered into a 10-year real estate secured loan with MUFG Union Bank, N.A. ("Union Bank") for \$35.7 million in January 2017. This loan has a variable interest rate of 30-day LIBOR plus 1.7%, with monthly principal and interest payments, maturing in 2027. The monthly principal and interest payments begin in April 2019. The Company also entered into an interest rate hedge with Union Bank for \$35.7 million, the notional amount. Under the hedge, the Company will receive variable interest equal to 30-day LIBOR plus 1.7% and pay fixed interest at a rate of 3.65%, with an effective date of March 1, 2017 and maturity date of March 1, 2027.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

As of February 28, 2018, the Company had approximately \$84.4 million of long-term loans in the U.S., Trinidad, Panama, El Salvador, Honduras, Costa Rica, Barbados and Colombia that require these subsidiaries to comply with certain annual or quarterly financial covenants, which include debt service and leverage ratios. As of February 28, 2018, the Company was in compliance with all covenants or amended covenants.

As of August 31, 2017, the Company had approximately \$85.6 million of long-term loans in Trinidad, Panama, El Salvador, Honduras, Costa Rica, Barbados and Colombia that require these subsidiaries to comply with certain annual or quarterly financial covenants, which include debt service and leverage ratios. As of August 31, 2017, the Company was in compliance with all covenants or amended covenants.

Annual maturities of long-term debt are as follows (in thousands):

Twelve Months Ended February 28,	Amount
2018	\$ 14,160
2019	24,804
2020	11,932
2021	4,847
2022	3,472
Thereafter	37,457
Total	\$ 96,672

NOTE 7 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company is exposed to interest rate risk relating to its ongoing business operations. To manage interest rate exposure, the Company enters into hedge transactions (interest rate swaps) using derivative financial instruments. The objective of entering into interest rate swaps is to eliminate the variability of cash flows in the LIBOR interest payments associated with variable-rate loans over the life of the loans. As changes in interest rates impact the future cash flow of interest payments, the hedges provide a synthetic offset to interest rate movements.

In addition, the Company is exposed to foreign currency and interest rate cash flow exposure related to non-functional currency long-term debt of three of its wholly owned subsidiaries. To manage this foreign currency and interest rate cash flow exposure, the Company's subsidiaries entered into cross-currency interest rate swaps that convert their U.S. dollar denominated floating interest payments to functional currency fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of interest payments, the hedges are intended to offset changes in cash flows attributable to interest rate and foreign exchange movements.

These derivative instruments (cash flow hedging instruments) are designated and qualify as cash flow hedges, with the entire gain or loss on the derivative reported as a component of other comprehensive income (loss). Amounts are deferred in other comprehensive income (loss) and reclassified into earnings in the same income statement line item that is used to present earnings effect of the hedged item when the hedged item affects earnings.

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business, including 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. These 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 do not qualify for derivative hedge accounting. 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.

Cash Flow Hedges

As of February 28, 2018, all of the Company's interest rate swap and cross-currency interest rate swap derivative financial instruments are designated and qualify as cash flow hedges. The Company formally documents the hedging relationships for its derivative instruments that qualify for hedge accounting.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes agreements for which the Company has recorded cash flow hedge accounting for the six months ended February 28, 2018:

Subsidiary	Date Entered into	Derivative Financial Counter-party	Derivative Financial Instruments	Initial US\$ Notional Amount	Bank US\$ loan Held with	Floating Leg (swap counter-party)	Fixed Rate for PSMT Subsidiary	Settlement Dates
PriceSmart, Inc (1)	7-Nov-16	MUFG Union Bank, N.A. ("Union Bank")	Interest rate swap	\$ 35,700,000	Union Bank	Variable rate 1-month LIBOR plus 1.7%	3.65 %	1st day of each month beginning April 1, 2017
Costa Rica	28-Aug-15	Citibank, N.A. ("Citi")	Cross currency interest rate swap	\$ 7,500,000	Citibank, N.A.	Variable rate 3-month LIBOR plus 2.50%	7.65 %	28th day of August, November, February and May beginning on November 3, 2015
Honduras (2)	24-Mar-15	Citibank, N.A. ("Citi")	Cross currency interest rate swap	\$ 8,500,000	Citibank, N.A.	Variable rate 3-month LIBOR plus 3.25%	10.75 %	24th day of March, June, September, December beginning on June 24, 2015
Honduras	26-Feb-18	Citibank, N.A. ("Citi")	Cross currency interest rate swap	\$ 13,500,000	Citibank, N.A.	Variable rate 3-month LIBOR plus 3.00%	9.75 %	29th day of May, August, November and February beginning on May 29, 2015
El Salvador	16-Dec-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 4,000,000	Bank of Nova Scotia	Variable rate 30-day LIBOR plus 3.5%	4.78 %	29th day of each month beginning December 29, 2014
Colombia	10-Dec-14	Citibank, N.A. ("Citi")	Cross currency interest rate swap	\$ 15,000,000	Citibank, N.A.	Variable rate 3-month LIBOR plus 2.8%	8.25 %	4th day of March, June, Sept, Dec beginning on March 4, 2015
Panama	9-Dec-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 10,000,000	Bank of Nova Scotia	Variable rate 30-day LIBOR plus	5.16 %	28th day of each month beginning December 29, 2014

Edgar Filing: PRICESMART INC - Form 10-Q

Honduras	23-Oct-14	Citibank, N.A. ("Citi")	Cross currency interest rate swap	\$ 5,000,000	Citibank, N.A.	3.5% Variable rate 3-month LIBOR plus 3.5%	11.6	%	22nd day of Jan April, July, and October beginn on January 22, 2
Panama	1-Aug-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 5,000,000	Bank of Nova Scotia	Variable rate 30-day LIBOR plus 3.5%	4.89	%	21st day of each month beginnin September 22, 2
Panama	22-May-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 3,970,000	Bank of Nova Scotia	Variable rate 30-day LIBOR plus 3.5%	4.98	%	4th day of each month beginnin June 4, 2014

(1) The initial notional amount and fixed rate were modified effective January 2017.

(2) In February 2018, the Company's Honduras subsidiary refinanced its portfolio of loans entered into with Citibank. The original notional amount of this portfolio of loans was \$13.5 million, which the Company drew down in fiscal 2015. There was approximately \$7.9 million of remaining principal at the time of the refinancing. Under the refinancing agreement, the portfolio of loans was combined into one loan and the notional amount of the loan increased back to the original \$13.5 million, with the interest rate set at the 90 day LIBOR rate plus 3.0%. In conjunction with the refinancing of these loans, the Company's Honduras subsidiary drew down the additional \$5.6 million notional amount during February 2018. As part of the terms, the existing cash flow hedge related to the original loan, was de-designated and incorporated into a new hedging relationship where the Company's Honduras subsidiary has entered into a cross-currency interest rate swap with Citibank. Under this new hedge agreement, the Company's Honduras subsidiary will pay Honduras Lempiras, at a fixed interest rate of 9.75%.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

For the three and six months ended February 28, 2018 and 2017, the Company included the gain or loss on the hedged items (that is, variable-rate borrowings) in the same line item—interest expense—as the offsetting gain or loss on the related interest rate swaps as follows (in thousands):

Income Statement Classification	Interest expense on borrowings(1)	Cost of swaps (2)	Total
Interest expense for the three months ended February 28, 2018	\$ 873	\$ 176	\$ 1,049
Interest expense for the three months ended February 28, 2017	\$ 755	\$ 358	\$ 1,113
Interest expense for the six months ended February 28, 2018	\$ 1,723	\$ 497	\$ 2,220
Interest expense for the six months ended February 28, 2017	\$ 1,504	\$ 782	\$ 2,286

(1) This amount is representative of the interest expense recognized on the underlying hedged transactions.

(2) This amount is representative of the interest expense recognized on the cross-currency interest rate swaps designated as cash flow hedging instruments.

The total notional balance of the Company's pay-fixed/receive-variable interest rate swaps and cross-currency interest rate swaps was as follows (in thousands):

Floating Rate Payer (Swap Counterparty)	Notional Amount as of	
	February 28, 2018	August 31, 2017
Union Bank	\$ 35,700	\$ 35,700
Citibank N.A.	29,625	26,088
Scotiabank	12,124	13,724
Total	\$ 77,449	\$ 75,512

Edgar Filing: PRICESMART INC - Form 10-Q

Derivatives listed on the table below were designated as cash flow hedging instruments. The table summarizes the effect of the fair value of interest rate swap and cross-currency interest rate swap derivative instruments that qualify for derivative hedge accounting and its associated tax effect on accumulated other comprehensive (income)/loss (in thousands):

Derivatives designated as cash flow hedging instruments	Balance Sheet Location	February 28, 2018			August 31, 2017		
		Fair Value	Net Tax Effect	Net OCI	Fair Value	Net Tax Effect	Net OCI
Cross-currency interest rate swaps	Other non-current assets	\$ 2,066	(624)	1,442	\$ 2,547	\$ (950)	\$ 1,597
Interest rate swaps	Other non-current assets	1,964	(440)	1,524	—	—	—
Interest rate swaps	Other long-term liabilities	—	—	—	(231)	80	(151)
Cross-currency interest rate swaps	Other long-term liabilities	(670)	201	(469)	(451)	135	(316)
Net fair value of derivatives designated as hedging instruments		\$ 3,360	\$ (863)	\$ 2,497	\$ 1,865	\$ (735)	\$ 1,130

Fair Value Instruments

From time to time the Company enters into non-deliverable forward foreign-exchange contracts. These contracts are treated for accounting purposes as fair value contracts and do not qualify for derivative hedge accounting. The use of non-deliverable forward foreign-exchange contracts is intended to offset changes in cash flow attributable to currency exchange movements. These contracts are intended primarily to economically hedge 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.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

As of February 28, 2018 and August 31, 2017, the Company had no non-deliverable forward foreign-exchange contracts; therefore, no related assets or liabilities for either the notional value or the market value of such instruments were recorded on the consolidated balance sheet at February 28, 2018 or August 31, 2017.

For the three and six months ended February 28, 2018 and 2017, the Company included in its consolidated statements of income the forward derivative gain or (loss) on the non-deliverable forward foreign-exchange contracts as follows (in thousands):

Income Statement Classification	Three Months Ended		Six Months Ended	
	February 28, 2018	February 28, 2017	February 28, 2018	February 28, 2017
Other income (expense), net	\$ (27)	\$ 64	\$ 66	\$ 283

NOTE 8 – SEGMENTS

The Company and its subsidiaries are principally engaged in the international operation of membership shopping in 40 warehouse clubs located in 13 countries/territories that are located in Central America, the Caribbean and Colombia. In addition, the Company operates distribution centers and corporate offices in the United States. The Company has aggregated its warehouse clubs, distribution centers and corporate offices into reportable segments. The Company's reportable segments are based on management's organization of these locations into operating segments by general geographic location, used by management and the Company's chief operating decision maker in setting up management lines of responsibility, providing support services, and making operational decisions and assessments of financial performance. Segment amounts are presented after converting to U.S. dollars and consolidating eliminations. Certain revenues, operating costs and inter-company charges included in the United States segment are not allocated to the segments within this presentation, as it is impractical to do so, and they appear as reconciling items to reflect the amount eliminated on consolidation of intersegment transactions. From time to time, the Company revises the measurement of each segment's operating income and net income, including certain corporate overhead allocations, and other measures as determined by the information regularly reviewed by the Company's chief operating decision maker. When the Company does so, the previous period amounts and balances are reclassified to conform to the current period's presentation.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following tables summarize by segment certain revenues, operating costs and balance sheet items (in thousands):

	United States Operations	Central American Operations	Caribbean Operations	Colombia Operations	Reconciling Items(1)	Total
Three Months Ended February 28, 2018						
Revenue from external customers	\$ 9,138	\$ 493,905	\$ 234,169	\$ 102,351	\$ —	\$ 839,563
Intersegment revenues	274,061	—	971	119	(275,151)	—
Depreciation and amortization	1,691	5,886	2,732	2,266	—	12,575
Operating income	1,146	36,673	13,601	3,161	(17,317)	37,264
Net income (loss)	(13,825)	30,124	12,456	2,710	(17,317)	14,148
Capital expenditures, net	584	11,191	9,332	1,024	—	22,131
Six Months Ended February 28, 2018						
Revenue from external customers	\$ 17,285	\$ 946,071	\$ 448,811	\$ 194,468	\$ —	\$ 1,606,635
Intersegment revenues	614,189	—	2,178	317	(616,684)	—
Depreciation and amortization	3,435	11,409	5,409	4,559	—	24,812
Operating income	4,237	69,206	25,225	5,209	(33,447)	70,430
Net income (loss)	(14,390)	57,512	22,926	4,037	(33,447)	36,638
Capital expenditures, net	1,588	22,561	19,629	1,856	—	45,634
Long-lived assets (other than deferred tax assets)	68,597	308,085	136,589	126,914	—	640,185
Goodwill	—	30,926	4,547	—	—	35,473
Total assets	129,623	552,343	320,848	188,910	—	1,191,724
Three Months Ended February 28, 2017						
Revenue from external customers	\$ 8,171	\$ 473,994	\$ 219,515	\$ 91,616	\$ —	\$ 793,296
Intersegment revenues	270,369	—	1,175	12	(271,556)	—
Depreciation and amortization	1,475	5,140	2,531	2,299	—	11,445
Operating income	2,324	37,462	13,611	915	(14,910)	39,402
Net income	4,135	29,636	8,221	137	(14,910)	27,219
Capital expenditures, net	49,792	15,461	2,101	1,045	—	68,399
Six Months Ended February 28, 2017						
Revenue from external customers	\$ 18,926	\$ 912,228	\$ 426,537	\$ 175,177	\$ —	\$ 1,532,868

Edgar Filing: PRICESMART INC - Form 10-Q

Intersegment revenues	588,031	—	2,873	22	(590,926)	—
Depreciation and amortization	3,049	10,004	4,989	4,520	—	22,562
Operating income	9,921	70,966	25,825	1,828	(30,759)	77,781
Net income	7,793	55,863	19,082	109	(30,759)	52,088
Capital expenditures, net	52,129	26,217	6,539	1,518	—	86,403
Long-lived assets (other than deferred tax assets)	68,872	288,855	109,353	134,833	—	601,913
Goodwill	—	31,153	4,539	—	—	35,692
Total assets	126,494	538,628	300,983	190,847	—	1,156,952
As of August 31, 2017						
Long-lived assets (other than deferred tax assets)	\$ 70,353	\$ 296,915	\$ 122,616	\$ 126,206	\$ —	\$ 616,090
Goodwill	—	31,118	4,524	—	—	35,642
Total assets	147,650	544,683	303,234	181,947	—	1,177,514

(1) The reconciling items reflect the amount eliminated on consolidation of intersegment transactions.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 9 – SUBSEQUENT EVENTS

The Company has evaluated all events subsequent to the balance sheet date of February 28, 2018 through the date of issuance of these consolidated financial statements and has determined that, except as set forth below, there are no subsequent events that require disclosure.

Acquisition

On March 15, 2018, the Company acquired Aeropost, Inc., a cross-border logistics and e-commerce provider with presence throughout Latin America and the Caribbean, for total consideration of \$30.0 million. Aeropost brings to PriceSmart a technology and development team, which the Company can leverage to offer new online shopping options for our members.

Financing Transactions

On March 22, 2018, the Company's Panama subsidiary entered into a loan agreement with Scotiabank. The agreement provides for a US \$15.0 million loan to be repaid in five years with quarterly interest and principal payments. The interest rate is set at the 90 day LIBOR rate plus 3%. The loan was funded on March 23, 2018.

Table of Contents

PRICESMART, INC.

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

This Quarterly Report on Form 10-Q contains forward-looking statements concerning PriceSmart Inc.'s ("PriceSmart", the "Company" or "we") anticipated future revenues and earnings, adequacy of future cash flows, proposed warehouse club openings, the Company's performance relative to competitors and related matters. These forward-looking statements include, but are not limited to, statements containing the words "expect," "believe," "will," "may," "should," "project," "estimate," "anticipated," "scheduled," and like expressions, and the negative thereof. These statements are subject to risks and uncertainties that could cause actual results to differ materially including, but not limited to, the following external and internal risks:

External Risks

- Natural disasters that might cause damages not covered by insurance;
- Negative macroeconomic conditions;
- Volatility in foreign currency exchange rates and limitations on our ability to convert foreign currency to US dollars;
- Changes in, and inconsistent enforcement of laws and regulations in countries where we operate, including those related to tariffs and taxes;
- Compliance risks;
- Crime and security concerns, which can adversely affect the economies of the countries in which we operate and which require us to incur additional costs to provide additional security at our warehouse clubs;
- Recoverability of moneys owed to PriceSmart from governments in countries where we do business; and
- The possibility of operational interruptions related to union work stoppages;

Internal Risks:

- We might not identify or effectively respond to changes in consumer shopping preferences with resulting negative effects on our sales and market share;
- Significant competition, including from international online retailers;
 - Limitations on the availability of appropriate sites for new warehouse clubs could adversely affect growth;
- We may experience increased costs, delays or failure in our efforts to integrate our online commerce with our traditional brick and mortar business;

- Cost increases from product and service providers;
- Interruption of supply chains, which might adversely impact on our ability to import merchandise;
- Failure to maintain our brand's reputation;
- Exposure to product liability claims and product recalls;
- Failure to maintain our computer systems and/or disruption in those systems;
- Delays or cost overruns implementing our new Enterprise Resource Planning system;
- Any failure to maintain the security of the information we hold relating to our company, our members, employees and suppliers;
 - Failure to attract and retain qualified employees, significant increases in wage and benefit expenses, or changes in labor laws with consequent material adverse effect on our financial performance;
- Changes in accounting standards affecting management's financial assumptions, projections, estimates and judgments; and
- a few of our stockholders own approximately 25.3% of our voting stock as of February 28, 2018, which may make it difficult to complete some corporate transactions without their support and may impede a change in control

The risks described above as well as the other risks detailed in the Company's U.S. Securities and Exchange Commission ("SEC") reports, including the Company's Annual Report on Form 10-K filed for the fiscal year ended August 31, 2017 filed on October 26, 2017, pursuant to the Securities Exchange Act of 1934, see "Part I - Item 1A - Risk Factors," could materially and adversely affect our business, financial condition and results of operations. These risks are not the only risks that the Company faces. The Company could also be affected by additional factors that apply to all companies operating globally and in the U.S., as well as other risks that are not presently known to the Company or that the Company currently considers to be immaterial.

Table of Contents

The following discussion and analysis compares the results of operations for the three and six months ended February 28, 2018 and 2017 and should be read in conjunction with the consolidated financial statements and the accompanying notes included therein.

Our business consists primarily of operating international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. We operate in 13 countries/territories that are located in Latin America and the Caribbean. Our ownership in all operating subsidiaries as of February 28, 2018 is 100%, and they are presented on a consolidated basis. The number of warehouse clubs in operation as of February 28, 2018 for each country or territory are as follows:

Country/Territory	Number of Warehouse Clubs in Operation as of August 31, 2017	Number of Warehouse Clubs in Operation as of February 28, 2018	Anticipated Additional Warehouse Club Openings In Fiscal Year 2018
Colombia	7	7	—
Costa Rica	6	7	—
Panama	5	5	—
Trinidad	4	4	—
Dominican Republic	3	3	1
Guatemala	3	3	—
Honduras	3	3	—
El Salvador	2	2	—
Nicaragua	2	2	—
Aruba	1	1	—
Barbados	1	1	—
U.S. Virgin Islands	1	1	—
Jamaica	1	1	—
Totals	39	40	1

Our warehouse clubs and local distribution centers are located in Latin America and the Caribbean, and our corporate headquarters, U.S. buying operations and regional distribution centers are located primarily in the United States. Our operating segments are the United States, Central America, the Caribbean and Colombia.

We opened a new warehouse club in Santa Ana, Costa Rica in October 2017, bringing the total warehouse clubs operating in Costa Rica to seven. In June 2017, we acquired land in Santo Domingo, Dominican Republic. We are currently building a warehouse club on this site that we expect to open in May of 2018. This will bring the number of PriceSmart warehouse clubs operating in Dominican Republic to four. We continue to explore other potential sites for future warehouse clubs in Central America, the Caribbean and Colombia.

General Market Factors

Our sales and profits vary from market to market depending on general economic factors, including GDP growth; consumer spending patterns; foreign currency exchange rates; political policies and social conditions; local demographic characteristics (such as population growth); the number of years PriceSmart has operated in a particular market; and the level of retail and wholesale competition in that market.

Currency fluctuations can be one of the largest variables affecting our overall sales and profit performance, as we have experienced in prior fiscal years, because many of our markets are susceptible to foreign currency exchange rate volatility. In the first six months of fiscal year 2018 and during fiscal year 2017, approximately 78% and 77%, respectively, of our net warehouse sales were in currencies other than the U.S. dollar. Of those sales that were currencies other than the U.S. dollar, approximately 52% were comprised of sales of products we purchased in U.S. dollars. A devaluation of the local currency not only reduces the value of sales and membership income that is generated in that country when translated to U.S. dollars for our consolidated results, but also increases the local currency price of imported merchandise, which impacts demand for a significant portion of the Company's merchandise offering. For example, changes in the value of the Colombian peso ("COP") relative to the U.S. dollar negatively impacted sales and margins in that market during fiscal years 2015 and 2016. A stabilization of the currency during fiscal year 2017 contributed to improving business conditions in Colombia, resulting in sales growth and a return to operating profitability in our Colombia segment that has continued into the first six months of fiscal year 2018.

Table of Contents

From time to time the markets in which we operate experience cycles of economic activity that can negatively impact our business. For example, Trinidad, which depends on oil and gas exports as a major source of income, has been experiencing overall difficult economic conditions for the past 18 months. These adverse economic conditions, combined with government policies intended to manage foreign currency reserves, have adversely affected consumer spending. Other countries where recent general market conditions have provided a difficult operating environment during the first six months of fiscal year 2018 include Panama and Barbados. Our business in USVI, where Hurricanes Irma and Maria had a severe impact on the infrastructure of the island in September and October, has rebounded due to the re-construction efforts and the difficulty other retailers are having in becoming fully operational.

Our capture of retail and wholesale sales can vary from market to market due to competition and the availability of other shopping options for our members. In larger, more developed countries, such as Costa Rica, Panama and Colombia, customers have many alternatives available to them to satisfy their shopping needs, and therefore, our market share is less than in other smaller countries, such as Jamaica and Nicaragua, where consumers have a limited number of shopping options.

Demographic characteristics within each of our markets can also affect both the overall level of sales and also future sales growth opportunities. Island countries such as Aruba, Barbados and the U.S. Virgin Islands offer us limited upside for sales growth given their overall market size. Countries with a smaller upper and middle class consumer population, such as Honduras, El Salvador, Jamaica and Nicaragua, also have a more limited potential opportunity for sales growth as compared to more developed countries with larger upper and middle class consumer populations.

Political and other factors in each of our markets may have significant effects on our business. For example, when national elections are being held, the political situation can introduce uncertainty about how the leadership change may impact the economy and affect near-term consumer spending. As has been the case during the first six months of fiscal year 2018 in Honduras, political turmoil can result in local unrest, resulting in curfews and reduced operating hours, and interrupt the normal flow of merchandise to our warehouse clubs. The need for increased tax revenue in certain countries can cause changes in tax policies affecting consumer's personal tax rates and/or added consumption taxes, such as VAT (value-added taxes), effectively raising the prices of various products and impacting demand.

In the past we have experienced a lack of availability of U.S. dollars in certain markets (U.S. dollar illiquidity). This impedes our ability to convert local currencies obtained through warehouse sales into U.S. dollars to settle the U.S. dollar liabilities associated with our imported products, increasing our foreign exchange exposure to any devaluation of the local currency relative to the U.S. dollar. During fiscal year 2017 and continuing into the first six months of fiscal year 2018, we experienced this situation in Trinidad ("TT"). We are working with our banks in Trinidad to source tradable currencies (including Euros and Canadian dollars), but until the central bank in Trinidad makes more U.S. dollars available, this illiquidity condition is likely to continue. During part of the first half of fiscal year 2017, we limited shipments of merchandise to Trinidad from our distribution center in Miami to levels that generally aligned with our Trinidad subsidiary's ability to source U.S. dollars to pay for that merchandise. This resulted in a reduced level of shipments, which negatively affected sales in the second quarter, particularly December 2016, although by

less than our initial estimate. These actions did not impact the level of merchandise we obtain locally in Trinidad.

Starting in the third quarter of fiscal year 2017, we were able to improve our sourcing of tradeable currencies, which, in addition to other steps we took, allowed for a more normalized flow of imported merchandise during the third and fourth fiscal quarters. Over the past six months, however, we have been unable to source a sufficient level of tradeable currencies in Trinidad consistent with the level of merchandise we are importing. As of February 28, 2018, our Trinidad subsidiary had net U.S. dollar denominated liability exposures of approximately \$10.1 million, an increase of \$14.1 million from August 31, 2017 when our Trinidad subsidiary had net U.S. dollar denominated assets position of approximately \$4.0 million. We are carefully monitoring the situation, which may require us to limit future shipments from the U.S. to Trinidad in line with our ability to exchange Trinidad dollars for tradeable currencies to manage our exposure to any potential devaluation.

Business Strategy

Our business strategy is to operate membership warehouse clubs in Latin America and the Caribbean islands with a limited selection of high volume products at the best possible prices. PriceSmart members pay an annual membership fee. That fee, combined with volume purchasing and operating efficiencies throughout the supply chain, enable us to operate our business with lower margins and prices than conventional retail stores and wholesale suppliers. We are in the process of expanding our strategy to include online shopping and the strategic placement of regional distribution centers to support both our traditional warehouse club business and our new online shopping initiative.

While our traditional membership warehouse club strategy continues to work well in our markets, we recognize that technology is having an increasingly profound impact on shopping habits throughout the world. We believe our business strategy needs to be broadened to respond to changes in shopping habits so our members will have the shopping experience they desire. Our longer range strategic objective is to combine the traditional membership warehouse club “brick and mortar” business with online shopping to provide the best shopping experience possible for our members.

Table of Contents

Growth

We measure our growth primarily by the amount of the period-over-period activity in our net warehouse sales, our comparable warehouse club sales and our membership income. At times, we make strategic investments that are focused on the long-term growth of the Company. These investments can impact near-term results, such as when we incur fixed costs in advance of achieving full projected sales, negatively impacting near-term operating profit and net income, or when we open a new warehouse club in an existing market, which can reduce reported comparable warehouse sales due to the cannibalization of sales from existing warehouse clubs.

Current and Future Management Actions

Logistics and distribution efficiencies are an important part of what allows us to deliver high quality merchandise at low prices to our members. We acquire a significant amount of merchandise internationally, a significant portion of which we receive at our Miami distribution centers. In January 2017, we purchased a distribution center in Medley, Miami-Dade County, Florida, into which we transferred our Miami dry distribution center activities from a leased facility during the third quarter of fiscal year 2017. This new distribution facility has increased our ability to efficiently receive, handle and distribute merchandise. We then ship the merchandise either directly to our warehouse clubs or to regional distribution centers located in some of our larger markets. Our ability to efficiently receive, handle and distribute merchandise to the point where our members put that merchandise into their shopping carts has a significant impact on our level of operating expenses and ultimately how low we can price our merchandise. We continue to explore ways to improve efficiency, reduce costs and ensure a good flow of merchandise to our warehouse clubs. As we continue to refine our logistics and distribution infrastructure, we are investing in regional distribution centers. We recently entered into a long-term lease for a 107,640 square foot distribution center in Costa Rica. We expect to begin operating this distribution center during the fall of 2018. In August of fiscal year 2017, we entered into a long-term lease for a 52,463 square foot distribution center in Panama that we occupied in September 2017. We expect that both these new distribution centers will improve the merchandise flow and in-stock conditions in our warehouse clubs, reduce merchandise costs and facilitate online sales to our members.

Purchasing land and constructing warehouse clubs is generally our largest ongoing capital investment. Securing land for warehouse club locations is challenging within our markets, especially in Colombia, because suitable sites at economically feasible prices are difficult to find. While our preference is to own rather than lease real estate, we have entered into real estate leases in certain cases (most recently our Bogota, Colombia site) and will likely do so in the future. Real estate ownership provides a number of advantages as compared to leasing, including lower operating expenses, flexibility to expand or otherwise enhance our buildings, long-term control over the use of the property and the residual value that the real estate may have in future years. In order to secure warehouse club locations, we occasionally have purchased more land than is actually needed for the warehouse club facility. To the extent that we acquire property in excess of what is needed for a particular warehouse club, we generally have looked to either sell or develop the excess property. Excess land at Alajuela (Costa Rica) and Brisas (Panama) is being developed by joint ventures formed by us and the sellers of the property. We are employing a similar development strategy for the excess

land at the San Fernando, Trinidad and Arroyo Hondo, Dominican Republic locations where the properties are fully owned by us. The profitable sale or development of excess real estate not required to operate a warehouse club is highly dependent on real estate market conditions.

We are currently engaged in the selection and implementation of a new Enterprise Resource Planning (ERP) system. The ERP system is software technology that serves virtually the entire core activities of our business by providing data management systems and a continuous flow of information for business operations. Our company has made the decision to replace our outdated technology that was no longer capable of serving our future requirements. Our new ERP will be “cloud” based and will provide a technology platform to support the future growth of our business. The new ERP system will be expensive, will require time to implement, and will place demands on our management team as they adapt to the new systems.

This past year our company created an Innovation Committee of the Board of Directors and an Innovation Management Team. Since its inception, the Innovation Committee and Team have focused most of their attention to the topic of online shopping technology, delivery services alternatives for online orders, and alternative methods of payment for our members. The Innovation Team is working with PriceSmart management to facilitate the integration of Aeropost into the operating systems of PriceSmart with the goal of realizing the benefits of the Aeropost acquisition. These benefits include efficient and low cost cross border delivery services, a wider assortment of products and services for members to purchase online, and a more user friendly ordering system and delivery services for PriceSmart members.

Table of Contents

Financial highlights for the three months ended February 28, 2018 included:

- Net warehouse club sales increased 5.7% over the same prior-year period. We ended the quarter with 40 warehouse clubs compared to 39 warehouse clubs at the end of the second quarter of fiscal year 2017.
- Comparable warehouse club sales (that is, sales in the warehouse clubs that have been open for greater than 13 1/2 calendar months) for the 13 weeks ended March 4, 2018 increased 4.1%.
- Membership income for the second quarter of fiscal year 2018 increased 7.4% to \$12.7 million over the comparable prior-year period.
- Warehouse gross profits (net warehouse club sales less associated cost of goods sold) increased 4.2% over the comparable prior year period and warehouse gross profits as a percent of net warehouse club sales were 14.4%, a decrease of 21 basis points (0.21%) from the same period last year.
- Operating income for the second quarter of fiscal year 2018 was \$37.3 million, compared to \$39.4 million in the second quarter of fiscal year 2017, which included the impact of a \$2.6 million charge associated with ending the internal development of an online platform in favor of leveraging the technology acquired with Aeropost and \$525,000 of deal costs for the acquisition of Aeropost.
- We recorded a \$210,000 net currency gain from currency transactions in the current quarter compared to a \$915,000 net currency gain in the same period last year.
- The tax provision of \$22.7 million resulted in an effective tax rate for the second quarter of fiscal year 2018 of 61.6%, mostly related to a one-time transitional repatriation tax on unremitted foreign earnings totaling \$13.4 million as part of the U.S. Tax Cuts and Jobs Act of 2017 (“U.S. Tax Reform”). The effective tax rate for the second quarter of fiscal year 2017 was 30.6%.
- Net income for the second quarter of fiscal year 2018 was \$14.1 million, or \$0.47 per diluted share, compared to \$27.2 million, or \$0.90 per diluted share, in the comparable prior-year period.

Financial highlights for the six months ended February 28, 2018 included:

- Net warehouse club sales increased 4.9% over the same prior year period. We ended the quarter with 40 warehouse clubs compared to 39 warehouse clubs at the end of the second quarter of fiscal year 2017.
- Comparable warehouse club sales (that is, sales in the warehouse clubs that have been open for greater than 13 1/2 calendar months) for the 26 weeks ended March 4, 2018 grew 3.2% from the comparable 13-week period a year ago.
- Membership income for the first six months of fiscal year 2018 increased 6.5% to \$25.1 million.
- Warehouse gross profits (net warehouse club sales less associated cost of goods sold) as a percent of net warehouse club sales for the first six months of fiscal year 2018 were 14.4%, a decrease of 36 basis points (0.36%) from the same period last year.
- Operating income for the first six months of fiscal year 2018 was \$70.4 million, a decrease of \$7.4 million over the first six months of fiscal year 2017, compared to \$77.8 million for the first six months of fiscal year 2017.
- We recorded a \$488,000 net currency gain from currency transactions in the current six-month period compared to a \$13,000 net currency loss in the same period last year.
- The effective tax rate for the first six months of fiscal year 2018 was 47.3%, mostly related to a one-time transitional repatriation tax on unremitted foreign earnings totaling \$13.4 million as part of the U.S. Tax Reform. The effective tax rate was 31.0% for the first six months of February 28, 2017.

- Net income for the first six months of fiscal year 2018 was \$36.6 million, or \$1.21 per diluted share, compared to \$52.1 million, or \$1.72 per diluted share, in the comparable prior year period.

COMPARISON OF THE THREE AND SIX MONTHS ENDED FEBRUARY 28, 2018 AND 2017

The following discussion and analysis compares the results of operations for the three-month and six-month periods ended on February 28, 2018 with the three-month and six-month periods ended on February 28, 2017 and should be read in conjunction with the consolidated financial statements and the accompanying notes included elsewhere in this report. Unless otherwise noted, all tables on the following pages present U.S. dollar amounts in thousands. Certain percentages presented are calculated using actual results prior to rounding.

Table of Contents

Net Warehouse Club Sales

The following tables indicate the net warehouse club sales in the segments in which we operate, and the percentage growth in net warehouse club sales by segment during the three and six months ended February 28, 2018 and 2017.

Three Months Ended

February 28, 2018

February 28, 2017

	Amount	% of net sales	Increase/ (decrease) from prior year	Change	Amount	% of net sales
Central America	\$ 485,279	59.4 %	\$ 19,471	4.2 %	\$ 465,808	60.3 %
Caribbean	230,831	28.3 %	14,428	6.7 %	216,403	28.0 %
Colombia	100,463	12.3 %	10,401	11.5 %	90,062	11.7 %
Net warehouse club sales	\$ 816,573	100.0 %	\$ 44,300	5.7 %	\$ 772,273	100.0 %

Six Months Ended

February 28, 2018

February 28, 2017

	Amount	% of net sales	Increase/ (decrease) from prior year	Change	Amount	% of net sales
Central America	\$ 928,946	59.5 %	\$ 32,961	3.7 %	\$ 895,985	60.2 %
Caribbean	442,270	28.3 %	21,967	5.2 %	420,303	28.2 %
Colombia	190,758	12.2 %	18,694	10.9 %	172,064	11.6 %
Net warehouse club sales	\$ 1,561,974	100.0 %	\$ 73,622	4.9 %	\$ 1,488,352	100.0 %

Comparison of Three Months and Six Months Ended February 28, 2018 and 2017

Overall net warehouse sales growth of 5.7% for the second quarter resulted from a 4.9% increase in transactions and a 0.8% increase in average ticket. For the six months ended February 28, 2018, sales growth of 4.9% resulted from a 4.7% increase in transactions and a 0.2% increase in average ticket.

Net warehouse sales in our Central America segment increased 4.2% and 3.7% for the second quarter and the first six months of fiscal year 2018, respectively, primarily due to the addition of the Santa Ana, Costa Rica warehouse club that opened in October 2017, and overall positive sales growth in Costa Rica. Panama experienced lower sales for the quarter and for the first six months of the fiscal year. All other Central American countries recorded positive growth in warehouse sales for the three-month and six-month period.

The Caribbean segment continued to show improvement in sales growth from the past few quarters. Trinidad, our largest market in the segment, returned to positive sales growth of 5.2%, a marked improvement from the flat or negative sales growth experienced in each five previous quarters. All other countries in the segment recorded positive sales growth for both the three-month and six-month periods, with the exception of Barbados. Sales in the Company's USVI warehouse club grew 40.7% and 28.3%, respectively, for the second quarter and for the first six months of fiscal year 2018. Despite significant business interruption in September due to the hurricanes that hit the island, the return to normal operations in October and November resulted in strong sales, for the near term, as some other retailers in the market have not fully recovered or remain closed.

Net warehouse sales in our Colombia segment continued to record the highest rate of growth at 11.5% and 10.9% for the three-month and for the six-month periods, respectively, compared to a year ago, with a growth in transactions being the primary driver.

Table of Contents

Comparable Sales

We report comparable warehouse club sales on a “same week” basis with 13 weeks in each quarter beginning on a Monday and ending on a Sunday. The periods are established at the beginning of the fiscal year to provide as close a match as possible to the calendar month and quarter that is used for financial reporting purposes. This approach equalizes the number of weekend days and weekdays in each period for improved sales comparison, as we experience higher warehouse club sales on the weekends. Further, each of the warehouse clubs used in the calculations was open for at least 13 ½ calendar months before its results for the current period were compared with its results for the prior period. For example, sales related to the warehouse opened in Costa Rica in October 2017 will not be used in the calculation of comparable sales until December 2018.

The following tables indicate comparable net warehouse club sales in the reportable segments in which we operate, and the percentage growth in net warehouse club sales by segment during fiscal years 2018 and 2017.

	Thirteen Weeks Ended			
	March 4, 2018		March 5, 2017	
	% Increase/(decrease)			
	in comparable			
	net		% Increase/(decrease)	
	warehouse	in comparable	in comparable	warehouse
	sales	net warehouse	sales	sales
Central America	1.1	%	1.4	%
Caribbean	7.2	%	(2.9)	%
Colombia	12.0	%	23.4	%
Consolidated segments	4.1	%	2.1	%

	Twenty-Six Weeks			
	Ended		March 5, 2017	
	March 4, 2018		March 5, 2017	
	% Increase			
	in comparable			

	net warehouse sales	%	net warehouse sales	%
Central America	0.6	%	1.1	%
Caribbean	5.4	%	(2.8)	%
Colombia	11.7	%	13.5	%
Consolidated segments	3.2	%	1.1	%

Comparison of Three and Six Months Ended February 28, 2018 and 2017

Comparable warehouse club sales for those warehouse clubs that were open for at least 13 ½ months for some or all of the 13-week period ended March 4, 2018 grew 4.1%. Comparable warehouse club sales for those warehouse clubs that were open for at least 13 ½ months for some or all of the 26-week period ended March 4, 2018 grew 3.2%.

Central America comparable warehouse club sales for the quarter and for the six-months were impacted by the opening of the Company's seventh warehouse club in Costa Rica in an area called Santa Ana. Often times, new warehouse clubs that we open are not far from existing warehouse clubs that are included in the calculation for comparable warehouse club sales, resulting in a transfer of some sales from an existing club (in this case Escazu) to the new club. This transfer of sales from existing warehouse clubs that are included in the calculation of comparable warehouse club sales to new warehouse clubs that are not included in the calculation can have an adverse impact on reported comparable warehouse club sales. We estimate that the transfer of sales associated with the Santa Ana opening negatively impacted the comparable warehouse club sales for the Central America segment by 189 basis points (1.89%) and by 174 basis points (1.74%) for the 13- and 26- week periods, respectively. New warehouse clubs attract new members from areas not previously served by us and also create the opportunity for some existing members, particularly those who now find the new clubs closer to their homes, to shop more frequently.

The Caribbean segment experienced positive comparable warehouse sales for both the 13- and 26- week periods on improving conditions in all markets compared to the year earlier period, particularly Trinidad, Dominican Republic and USVI.

Comparable warehouse club sales in Colombia for the 13-week and 26-week periods increased 12.0% and 11.7%, respectively. The comparable warehouse sales growth for the 13- and 26- week period in 2017 benefitted from the positive effect of a much stronger local currency compared to the prior year.

Table of Contents

Membership Income

	Three Months Ended February 28, 2018						February 28, 2017
					Membership income % to		
	Amount	Increase/ (decrease) from prior year	Change %	net warehouse club sales			Amount
Membership income - Central America	\$ 7,800	\$ 380	5.1 %	1.6 %			\$ 7,420
Membership income - Caribbean	3,146	196	6.6	1.4			2,950
Membership income - Colombia	1,757	294	20.1	1.7			1,463
Membership income - Total	\$ 12,703	\$ 870	7.4 %	1.6 %			\$ 11,833

	Six Months Ended February 28, 2018						February 28, 2017
					Membership income % to		
	Amount	Increase (decrease) from prior year	Change %	net warehouse club sales			Amount
Membership income - Central America	\$ 15,494	\$ 761	5.2 %	1.7 %			\$ 14,733
Membership income - Caribbean	6,164	261	4.4	1.4			5,903
Membership income - Colombia	3,420	513	17.6	1.8			2,907
Membership income - Total	\$ 25,078	\$ 1,535	6.5 %	1.6 %			\$ 23,543

Edgar Filing: PRICESMART INC - Form 10-Q

Number of accounts - Central America	838,379	21,329	2.6	%	817,050
Number of accounts - Caribbean	398,700	8,331	2.1		390,369
Number of accounts - Colombia	321,340	14,576	4.8		306,764
Number of accounts - Total	1,558,419	44,236	2.9	%	1,514,183

Comparison of Three and Six Months Ended February 28, 2018 and 2017

Membership income is recognized ratably over the one-year life of the membership. The average number of member accounts during the second quarter of fiscal year 2018 was 2.8% higher than during the same period a year ago. The income recognized per average member account increased 4.5%. In February 2017, we increased the annual membership fee in Colombia by 15.4% to COP 75,000, which had the effect of increasing the membership income per average membership account in Colombia by 14.1% in the quarter compared to the second quarter of last year. In addition, we introduced the Platinum membership in Panama and Dominican Republic which contributed to an increase in the membership income per average membership account by 3.8% (excluding Colombia).

The Company had a net increase of 44,236 membership accounts over the past twelve months. Membership accounts in Colombia increased 14,576 on improving renewal rates and continued new membership sign-ups, mostly associated with the Chia warehouse club. The Company's twelve-month renewal rate for the period ended February 28, 2018 was 85%, which is the same as the rate for the twelve-month period ended August 31, 2017. Excluding Colombia, the twelve-month renewal rate was 87% as of February 28, 2018.

Table of Contents

Results of Operations