

PRICESMART INC
Form 10-Q
July 07, 2016

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 May 31, 2016

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, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Yes No

The registrant had 30,394,175 shares of its common stock, par value \$0.0001 per share, outstanding at July 1, 2016.

PRICESMART, INC.

INDEX TO FORM 10-Q

	Page
<u>PART I - FINANCIAL INFORMATION</u>	
<u>ITEM 1. FINANCIAL STATEMENTS</u>	1
<u>CONSOLIDATED BALANCE SHEETS AS OF MAY 31, 2016 (UNAUDITED) AND AUGUST 31, 2015</u>	2
<u>CONSOLIDATED STATEMENTS OF INCOME FOR THE THREE AND NINE MONTHS ENDED MAY 31, 2016 AND 2015 - UNAUDITED</u>	4
<u>CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME FOR THE THREE AND NINE MONTHS ENDED MAY 31, 2016 AND 2015 - UNAUDITED</u>	5
<u>CONSOLIDATED STATEMENTS OF EQUITY FOR THE NINE MONTHS ENDED MAY 31, 2016 AND 2015 - UNAUDITED</u>	6
<u>CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE MONTHS ENDED MAY 31, 2016 AND 2015 - UNAUDITED</u>	7
<u>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED</u>	8
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	35
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	61
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	62
<u>PART II - OTHER INFORMATION</u>	
<u>ITEM 1. LEGAL PROCEEDINGS</u>	63
<u>ITEM 1A. RISK FACTORS</u>	63
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	63
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	64
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	64
<u>ITEM 5. OTHER INFORMATION</u>	64
<u>ITEM 6. EXHIBITS</u>	65

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 May 31, 2016 and the consolidated balance sheet as of August 31, 2015, the unaudited consolidated statements of income for the three and nine months ended May 31, 2016 and 2015, the unaudited consolidated statements of comprehensive income for the three and nine months ended May 31, 2016 and 2015, the unaudited consolidated statements of equity for the nine months ended May 31, 2016 and 2015, and the unaudited consolidated statements of cash flows for the nine months ended May 31, 2016 and 2015, 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)

	May 31, 2016 (Unaudited)	August 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 202,616	\$ 157,072
Short-term restricted cash	518	61
Receivables, net of allowance for doubtful accounts of \$0		
as of May 31, 2016 and August 31, 2015, respectively	5,949	9,662
Merchandise inventories	253,778	267,175
Prepaid expenses and other current assets	18,030	22,535
Total current assets	480,891	456,505
Long-term restricted cash	2,618	1,464
Property and equipment, net	456,584	433,040
Goodwill	35,652	35,871
Deferred tax assets	15,009	14,845
Other non-current assets (includes \$3,889 and \$4,129 as of May 31, 2016 and		
August 31, 2015, respectively, for the fair value of derivative instruments)	48,271	39,182
Investment in unconsolidated affiliates	10,798	10,317
Total Assets	\$ 1,049,823	\$ 991,224
LIABILITIES AND EQUITY		
Current Liabilities:		
Short-term borrowings	\$ 10,127	\$ 6,606
Accounts payable	245,096	241,978
Accrued salaries and benefits	18,502	17,977
Deferred membership income	21,127	20,184
Income taxes payable	5,425	9,595
Other accrued expenses (includes \$192 and \$66 as of May 31, 2016 and		
August 31, 2015, respectively, for the fair value of foreign currency forward contracts)	21,910	23,558
Dividends payable	10,629	—
Long-term debt, current portion	16,099	17,169
Total current liabilities	348,915	337,067
Deferred tax liabilities	1,879	1,755
Long-term portion of deferred rent	8,817	6,595

Edgar Filing: PRICESMART INC - Form 10-Q

Long-term income taxes payable, net of current portion	1,044	1,402
Long-term debt, net of current portion	71,462	73,365
Other long-term liabilities (includes \$1,684 and \$1,699 for the fair value of derivative instruments and \$3,791 and \$2,757 for post employment plans as of May 31, 2016 and August 31, 2015, respectively)	5,475	4,456
Total Liabilities	437,592	424,640

Table of Contents

Equity:

Common stock, \$0.0001 par value, 45,000,000 shares authorized; 31,214,715 and 30,977,764 shares issued and 30,394,175 and 30,184,584 shares outstanding (net of treasury shares) as of May 31, 2016 and August 31, 2015, respectively	3	3
Additional paid-in capital	409,979	403,168
Tax benefit from stock-based compensation	11,290	10,711
Accumulated other comprehensive loss	(106,431)	(101,512)
Retained earnings	328,804	283,611
Less: treasury stock at cost; 820,540 shares as of May 31, 2016 and 793,180 shares as of August 31, 2015	(31,414)	(29,397)
Total Equity	612,231	566,584
Total Liabilities and Equity	\$ 1,049,823	\$ 991,224

See accompanying notes.

Table of Contents

PRICESMART, INC.

CONSOLIDATED STATEMENTS OF INCOME

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

	Three Months Ended		Nine Months Ended	
	May 31,	May 31,	May 31,	May 31,
	2016	2015	2016	2015
Revenues:				
Net warehouse club sales	\$ 684,547	\$ 675,314	\$ 2,134,365	\$ 2,043,849
Export sales	7,091	9,465	21,872	24,126
Membership income	11,475	11,189	34,226	32,202
Other income	1,149	1,135	3,661	3,244
Total revenues	704,262	697,103	2,194,124	2,103,421
Operating expenses:				
Cost of goods sold:				
Net warehouse club	590,500	578,868	1,832,183	1,743,772
Export	6,742	8,992	20,799	22,953
Selling, general and administrative:				
Warehouse club operations	62,745	60,754	188,348	179,006
General and administrative	16,439	14,214	48,086	41,681
Pre-opening expenses	13	33	389	3,411
Loss/(gain) on disposal of assets	334	724	399	1,087
Total operating expenses	676,773	663,585	2,090,204	1,991,910
Operating income	27,489	33,518	103,920	111,511
Other income (expense):				
Interest income	322	283	780	813
Interest expense	(1,571)	(1,615)	(4,480)	(4,759)
Other income (expense), net	(222)	(311)	(1,018)	(4,602)
Total other income (expense)	(1,471)	(1,643)	(4,718)	(8,548)
Income before provision for income taxes and income (loss) of unconsolidated affiliates	26,018	31,875	99,202	102,963
Provision for income taxes	(9,168)	(10,750)	(33,113)	(36,378)
Income (loss) of unconsolidated affiliates	(13)	70	362	92
Net income	16,837	\$ 21,195	\$ 66,451	66,677
Net income per share available for distribution:				
Basic net income per share	\$ 0.55	\$ 0.70	\$ 2.19	\$ 2.20
Diluted net income per share	\$ 0.55	\$ 0.70	\$ 2.19	\$ 2.20
Shares used in per share computations:				
Basic	29,951	29,883	29,918	29,834

Edgar Filing: PRICESMART INC - Form 10-Q

Diluted	29,955	29,888	29,923	29,841
Dividends per share	\$ —	\$ —	\$ 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		Nine Months Ended	
	May 31, 2016	May 31, 2015	May 31, 2016	May 31, 2015
Net income	\$ 16,837	\$ 21,195	\$ 66,451	\$ 66,677
Other Comprehensive Income, net of tax:				
Foreign currency translation adjustments (1)	\$ 6,509	\$ (1,684)	\$ (4,383)	\$ (24,241)
Defined benefit pension plan:				
Amortization of prior service cost and actuarial gains included in net periodic pensions cost	(6)	(11)	(14)	(35)
Total defined benefit pension plan	(6)	(11)	(14)	(35)
Derivative instruments: (2)				
Unrealized gains/(losses) on change in fair value of interest rate swaps	(191)	38	(522)	3,506
Total derivative instruments	(191)	38	(522)	3,506
Other comprehensive income (loss)	6,312	(1,657)	(4,919)	(20,770)
Comprehensive income	\$ 23,149	\$ 19,538	\$ 61,532	\$ 45,907

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

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

See accompanying notes.

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	Treasury Stock Amount	Total Equity
Balance at August 31, 2014	30,951	\$ 3	\$ 397,150	\$ 9,505	\$ (49,286)	\$ 215,613	741	\$ (24,720)	\$ 548,265
Purchase of treasury stock	—	—	—	—	—	—	50	(4,500)	(4,500)
Issuance of restricted stock award	25	—	—	—	—	—	—	—	—
Forfeiture of restricted stock awards	(9)	—	—	—	—	—	—	—	—
Exercise of stock options	3	—	49	—	—	—	—	—	49
Stock-based compensation	—	—	4,622	1,220	—	—	—	—	5,842
Dividend paid to stockholders	—	—	—	—	—	(10,564)	—	—	(10,564)
Dividend payable to stockholders	—	—	—	—	—	(10,564)	—	—	(10,564)
Net income	—	—	—	—	—	66,677	—	—	66,677
Other comprehensive income (loss)	—	—	—	—	(20,770)	—	—	—	(20,770)
Balance at May 31, 2015	30,970	\$ 3	\$ 401,821	\$ 10,725	\$ (70,056)	\$ 261,162	791	\$ (29,220)	\$ 574,435
Balance at August 31, 2015	30,978	\$ 3	\$ 403,168	\$ 10,711	\$ (101,512)	\$ 283,611	793	\$ (29,397)	\$ 566,584
	—	—	—	—	—	—	27	(2,017)	(2,017)

Edgar Filing: PRICESMART INC - Form 10-Q

Purchase of treasury stock									
Issuance of restricted stock award	233	—	—	—	—	—	—	—	—
Forfeiture of restricted stock awards	—	—	—	—	—	—	—	—	—
Exercise of stock options	4	—	80	—	—	—	—	—	80
Stock-based compensation	—	—	6,731	579	—	—	—	—	7,310
Dividend paid to stockholders	—	—	—	—	—	(10,629)	—	—	(10,629)
Dividend payable to stockholders	—	—	—	—	—	(10,629)	—	—	(10,629)
Net income	—	—	—	—	—	66,451	—	—	66,451
Other comprehensive income (loss)	—	—	—	—	(4,919)	—	—	—	(4,919)
Balance at May 31, 2016	31,215	\$ 3	\$ 409,979	\$ 11,290	\$ (106,431)	\$ 328,804	820	\$ (31,414)	\$ 612,231

See accompanying notes.

Table of Contents

PRICESMART, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Nine Months Ended	
	May 31, 2016	May 31, 2015
Operating Activities:		
Net income	\$ 66,451	\$ 66,677
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	29,003	25,173
Allowance for doubtful accounts	—	2
(Gain)/loss on sale of property and equipment	399	1,087
Deferred income taxes	(1,222)	3,388
Excess tax benefit on stock-based compensation	(579)	(1,220)
Equity in (gains) losses of unconsolidated affiliates	(362)	(92)
Stock-based compensation	6,731	4,622
Change in operating assets and liabilities:		
Receivables, prepaid expenses and other current assets, accrued salaries and benefits, deferred membership income and other accruals	(2,281)	(9,101)
Merchandise inventories	13,397	(39,801)
Accounts payable	631	15,003
Net cash provided by (used in) operating activities	112,168	65,738
Investing Activities:		
Additions to property and equipment	(51,462)	(63,041)
Deposits for land purchase option agreements	(442)	903
Proceeds from disposal of property and equipment	96	67
Investment in joint ventures	(119)	(1,360)
Net cash provided by (used in) investing activities	(51,927)	(63,431)
Financing Activities:		
Proceeds from long-term bank borrowings	7,370	45,477
Repayment of long-term bank borrowings	(10,191)	(27,783)
Proceeds from short-term bank borrowings	18,829	34,970
Repayment of short-term bank borrowings	(15,214)	(33,300)
Cash dividend payments	(10,629)	(10,564)
Release of restricted cash	—	2,920
Excess tax benefit on stock-based compensation	579	1,220
Purchase of treasury stock	(2,017)	(4,500)
Proceeds from exercise of stock options	80	49
Net cash provided by (used in) financing activities	(11,193)	8,489
Effect of exchange rate changes on cash and cash equivalents	(3,504)	(2,301)

Edgar Filing: PRICESMART INC - Form 10-Q

Net increase (decrease) in cash and cash equivalents	45,544	8,495
Cash and cash equivalents at beginning of period	157,072	137,098
Cash and cash equivalents at end of period	\$ 202,616	\$ 145,593

Supplemental disclosure of cash flow information:

Cash paid during the period for:

Interest, net of amounts capitalized	\$ 3,991	\$ 4,391
Income taxes	\$ 39,297	\$ 33,583
Dividends declared but not paid	\$ 10,629	\$ 10,564

See accompanying notes.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

May 31, 2016

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 May 31, 2016, the Company had 38 consolidated warehouse clubs in operation in 12 countries and one U.S. territory (six in Costa Rica and Colombia; five in Panama; four in Trinidad; three in Guatemala, Honduras and the Dominican Republic; two in El Salvador and Nicaragua; and one each in Aruba, Barbados, Jamaica, and the United States Virgin Islands), of which the Company owns 100% of the corresponding legal entities (see Note 2 - Summary of Significant Accounting Policies). In January 2014, the Company acquired land in Pereira, Colombia and in the city of Medellin, Colombia and leased land in the city of Bogota, Colombia. The Company built new warehouse clubs at these three sites, and opened the Bogota location in October 2014 and opened the other two sites in November 2014. Together with the three warehouse clubs that were operating prior to these openings in Colombia (one in Barranquilla and two in Cali), these three new clubs brought the number of PriceSmart warehouse clubs operating in Colombia to six. In September 2014, the Company acquired land in La Chorrera ("Costa Verde"), west of Panama City, Panama, on which the Company opened its fifth PriceSmart warehouse club in Panama in June 2015. In April 2015, the Company acquired land in Managua, Nicaragua. The Company constructed and opened a warehouse club on this site in November 2015. In May 2015, the Company purchased land in Chia, a city north of Bogota, Colombia where it is currently constructing a new warehouse club that is expected to open in September 2016. On December 4, 2015, the Company signed an option to acquire two properties and then swap them for 59,353 square feet of land adjacent to our San Pedro Sula warehouse club in Honduras. The Company exercised the option and completed the swap in May 2016, and the acquired land will be used to expand the parking lot for the San Pedro Sula warehouse club. The Company continues to explore other potential sites for future warehouse clubs in Central America, the Caribbean and Colombia.

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

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

Reclassifications to consolidated balance sheet recorded during fiscal year 2016 for fiscal year 2015 – Certain reclassifications to the consolidated balance sheet have been made to prior fiscal year amounts to conform to the presentation in the current fiscal year.

The Company early adopted ASU 2015-17 as of the second quarter of fiscal year 2016 with retrospective application to prior periods. Accordingly, the Company reclassified current deferred tax assets and liabilities to long-term on its consolidated balance sheet reported for fiscal year ended 2015, which increased long-term deferred tax assets by \$7.4 million and decreased long-term deferred tax liabilities by \$438,000. As of the third quarter of fiscal year 2016, the Company no longer refers to these as Deferred tax assets-long term and Deferred tax liabilities-long term, and rather identifies them as Deferred tax assets and Deferred tax liabilities within their respective non-current balance sheet locations.

	August 31, 2015 balance sheet line item as previously reported	Amount reclassified	August 31, 2015 balance sheet line item as currently reported
Deferred tax assets- current	\$ 7,849	\$ (7,849)	\$ —
Deferred tax assets - non-current	\$ 7,464	\$ 7,381	\$ 14,845
Deferred tax liabilities - current	\$ 30	\$ (30)	\$ —
Deferred tax liabilities - non-current	\$ 2,193	\$ (438)	\$ 1,755

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 May 31, 2016, all of the Company’s subsidiaries were wholly owned. Additionally, the Company’s ownership interest in real estate development joint ventures as of May 31, 2016 is listed below:

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

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

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

Variable Interest Entities – The Company reviews and determines at the start of each arrangement, or subsequently if a reconsideration event occurs, whether any of its investments in joint ventures are Variable Interest Entities (“VIE”) and whether it must consolidate a VIE and/or disclose information about its involvement in a VIE. The Company has

determined that the joint ventures for GolfPark Plaza (Panama) and Price Plaza Alajuela (Costa Rica) are VIEs. The Company has determined that it is not the primary beneficiary of the VIEs and, therefore, has accounted for these entities under the equity method.

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

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

	May 31, 2016	August 31, 2015
Short-term restricted cash:		
Restricted cash for land purchase option agreements	\$ 442	\$ —
Other short-term restricted cash	\$ 76	\$ 61
Total short-term restricted cash	\$ 518	\$ 61
Long-term restricted cash:		
Other long-term restricted cash (1)	\$ 2,618	\$ 1,464
Total long-term restricted cash	\$ 2,618	\$ 1,464
Total restricted cash	\$ 3,136	\$ 1,525

(1) Other long-term restricted cash consists mainly of cash deposits held within banking institutions or with external fund managers in compliance with federal regulatory requirements in Panama to pay a specified benefit on retirement, voluntary departure or death of employees. Additionally, the Company records as long-term restricted cash amounts deposited in designated banking institutions for other regulatory requirements in Costa Rica.

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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 card processors to remit a portion of sales processed via credit card directly to the government as advance payments of VAT and/or income tax. In the case of VAT, these procedures alter the natural offset of input and output VAT and generally leave the Company with a net VAT receivable, forcing the Company to process significant refund claims on a recurring basis. With respect to income taxes paid, if the estimated income taxes paid or withheld exceed the actual income tax due, this creates an income tax receivable. The Company either requests a refund of these tax receivables or applies the balance to expected future tax payments. These refund or offset processes can take anywhere from several months to several years to complete.

In most countries where the Company operates, the tax refund process is defined and structured with regular refunds or offsets. However, in three countries there either is not, or the governments have alleged that there is not, a clearly defined process in the laws and regulations to allow the authorities to refund VAT receivables. The Company, together with its tax and legal advisers, is currently appealing these interpretations in court and expects to prevail. In one of these countries, where there is recent favorable jurisprudence, the government performed an audit to verify the amount of the VAT receivables as a required precursor to any refund. The balance of the VAT receivables in these countries was \$6.9 million and \$6.5 million as of May 31, 2016 and August 31, 2015, respectively. In another country in which the Company has warehouse clubs, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires the Company to pay taxes based on a percentage of sales rather than income. As a result, the Company is making income tax payments substantially in excess of those it would expect to pay based on taxable income. The current rules (which the Company has challenged in court) do not clearly allow the Company to obtain a refund or to offset this excess income tax against other taxes. As of May 31, 2016, the Company had deferred tax assets of approximately \$1.7 million in this country. Also, the Company had an income tax receivable balance of \$2.2 million as of May 31, 2016 related to excess payments from fiscal years 2015 and 2016. The Company has not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets, because the Company believes that it is more likely than not that it will succeed in its refund request and/or court challenge on this matter.

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

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

Edgar Filing: PRICESMART INC - Form 10-Q

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

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

	May 31, 2016	August 31, 2015
Prepaid expenses and other current assets	\$ 954	\$ 4,673
Other non-current assets	30,483	22,239
Total amount of VAT receivable reported	\$ 31,437	\$ 26,912

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

	May 31, 2016	August 31, 2015
Prepaid expenses and other current assets	\$ 3,619	\$ 2,941
Other non-current assets	10,017	8,772
Total amount of income tax receivable reported	\$ 13,636	\$ 11,713

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

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

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

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

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

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

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

Long-term restricted cash: Other long-term restricted cash consists mainly of cash deposits held within banking institutions or with external fund managers in compliance with federal regulatory requirements in Panama to pay a specified benefit on retirement, voluntary departure or death of employees. The amount of these payments is predetermined by a formula based on an employee's earnings history and tenure of service. Since the obligation to provide benefits are based on services that the employees have rendered, the cost associated with providing the benefits is recognized as the employee provides those services. The employees' rights to receive payment on these plans are not dependent on their reaching certain thresholds like age or tenure. Therefore, the carrying value approximates fair value because payments on these plans are not time dependent in nature. Additionally, the Company records as long-term restricted cash amounts deposited in designated banking institutions for other regulatory requirements in Costa Rica.

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

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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

Long-term debt: The fair value of debt is generally measured using a discounted cash flow analysis based on current market interest rates for similar types of financial instruments. These inputs are not quoted prices in active markets but they are either directly or indirectly observable; therefore, they are classified as Level 2 inputs. The carrying value and fair value of the Company's debt as of May 31, 2016 and August 31, 2015 is as follows (in thousands):

	May 31, 2016		August 31, 2015	
	Carrying Value	Fair Value(1)	Carrying Value	Fair Value(1)
Long-term debt, including current portion	\$ 87,561	\$ 85,441	\$ 90,534	\$ 88,307

(1) The Company has disclosed the fair value of long-term debt, including debt for which it has entered into cross-currency interest rate swaps, using the derivative obligation as of May 31, 2016 and August 31, 2015, to estimate the fair value of long-term debt, which includes the effects that the cross-currency interest rate swaps have had on the fair value of long-term debt.

Derivatives Instruments and Hedging Activities – The Company uses derivative financial instruments for hedging and non-trading purposes to manage its exposure to changes in interest and currency exchange rates. In using derivative financial instruments for the purpose of hedging the Company's exposure to interest and currency exchange rate risks, the contractual terms of a hedged instrument closely mirror those of the hedged item, providing a high degree of risk reduction and correlation. Contracts that are effective at meeting the risk reduction and correlation criteria (effective hedge) are recorded using hedge accounting. If a derivative financial instrument is an effective hedge, changes in the

fair value of the instrument will be offset in accumulated other comprehensive income (loss) until the hedged item completes its contractual term. If any portion of the hedge is deemed ineffective, the change in fair value of the hedged assets or liabilities will be immediately recognized in earnings during the period. Instruments that do not meet the criteria for hedge accounting, or contracts for which the Company has not elected hedge accounting, are valued at fair value with unrealized gains or losses reported in earnings during the period of the change. Valuation techniques utilized in the fair value measurement of assets and liabilities presented on the Company's consolidated balance sheets were not changed from previous practice during the reporting period. The Company seeks to manage counterparty risk associated with these contracts by limiting transactions to counterparties with which the Company has an established banking relationship. There can be no assurance, however, that this practice effectively mitigates counterparty risk.

Cash Flow Instruments. The Company is a party to receive floating interest rate, pay fixed-rate interest rate swaps to hedge the interest rate risk of certain U.S. dollar denominated debt within its international subsidiaries. The swaps are designated as cash flow hedges of interest expense risk. These instruments are considered effective hedges and are recorded using hedge accounting. The Company is also a party to receive variable interest rate, pay fixed interest rate cross-currency interest rate swaps to hedge the interest rate and currency exposure associated with the expected payments of principal and interest of U.S. denominated debt within its international subsidiaries whose functional currency is other than the U.S. dollar. The swaps are designated as cash flow hedges of the currency risk related to payments on the U.S. denominated debt. These instruments are also considered to be effective hedges and are recorded using hedge accounting. Under cash flow hedging, the effective portion of the fair value of the derivative, calculated as the net present value of the future cash flows, is deferred on the consolidated balance sheets in accumulated other comprehensive loss. If any portion of an interest rate swap is determined to be an ineffective hedge, the gains or losses from changes in fair value would be recorded directly in the consolidated statements of income. Amounts recorded in accumulated other comprehensive loss are released to earnings in the same period that the hedged transaction impacts consolidated earnings. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of interest rate swaps and cross-currency interest rate swaps as of May 31, 2016 and August 31, 2015.

Fair Value Instruments. The Company is exposed to foreign-currency exchange rate fluctuations in the normal course of business. The Company is also exposed to foreign-currency exchange rate fluctuations on U.S. dollar denominated liabilities within its international subsidiaries whose functional currency is other than the U.S. dollar. The Company manages these fluctuations, in part, through the use of non-deliverable forward foreign-exchange contracts that are intended to offset changes in cash flow attributable to currency exchange movements. The contracts are intended primarily to economically address exposure to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries whose functional currency

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 and are limited to less than one year in duration. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of open, unsettled forward foreign-exchange contracts as of May 31, 2016 and August 31, 2015.

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

The following tables summarize financial assets and liabilities measured and recorded at fair value on a recurring basis in the Company's consolidated balance sheet as of May 31, 2016 and August 31, 2015 (in thousands) for derivatives that qualify for hedge accounting:

Quoted Prices

Edgar Filing: PRICESMART INC - Form 10-Q

	in Active Markets for Identical	Significant Other Observable Inputs	Significant Unobservable Inputs	
Assets and Liabilities as of May 31, 2016	(Level 1)	(Level 2)	(Level 3)	Total
Other non-current assets – (Cross-currency interest rate swaps)	\$ —	\$ 3,889	\$ —	\$ 3,889
Other long-term liabilities – (Interest rate swaps)	—	(448)	—	(448)
Other long-term liabilities – (Cross-currency interest rate swaps)	—	(1,236)	—	(1,236)
Total	\$ —	\$ 2,205	\$ —	\$ 2,205

Quoted Prices

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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following tables summarize financial assets and liabilities measured and recorded at fair value on a recurring basis in the Company's consolidated balance sheet as of May 31, 2016 and August 31, 2015 (in thousands) for derivatives that do not qualify for hedge accounting:

	Quoted Prices in Active Markets for			
	Identical	Significant Other Observable Inputs	Significant Unobservable Inputs	Total
Assets and Liabilities as of May 31, 2016	(Level 1)	(Level 2)	(Level 3)	
Other accrued expenses (Foreign currency forward contracts)	\$ —	\$ (192)	\$ —	\$ (192)
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting	\$ —	\$ (192)	\$ —	\$ (192)

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

Goodwill – The table below presents goodwill resulting from certain business combinations as of May 31, 2016 and August 31, 2015 (in thousands). The change in goodwill is a result of foreign exchange translation losses.

	May 31, 2016	August 31, 2015	Change
Goodwill	\$ 35,652	\$ 35,871	\$ (219)

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

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

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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

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

The Company's Guatemala Pradera warehouse club experienced a fire in its merchandise receiving department during the early morning hours of June 4, 2015. No members or employees were in the warehouse club at the time. The fire was extinguished, but caused considerable smoke and some fire damage. The warehouse club was closed for nine days and reopened on June 13, 2015. The Company is insured for these costs and filed an insurance claim with its insurance provider. During the quarter ended August 31, 2015, the Company recorded an initial receivable of approximately \$2.8 million against the expected insurance payment related to expenses associated with the write off of inventory, equipment disposals, building repairs, other associated costs recognized related to the fire and for current replacement costs for assets lost in the fire in excess of the net book value (disposal cost). The Company received as of August 31, 2015 approximately \$300,000 in payments against the claim filed and the receivable recorded. Of this amount, approximately \$76,000 was recorded as a gain on disposal of assets, as proceeds received from the insurance reimbursement were in excess of the amount of loss recognized on the disposal of assets. Additionally, the Company recorded approximately \$28,000 for the disposal of assets damaged during the fire, for which it had not yet been reimbursed. As of August 31, 2015, the Company's receivable related to this insurance claim was approximately \$2.6 million. The Company's insurance policy also addresses coverage for business interruption. During the fourth quarter

of fiscal year 2015, the Company filed a claim with its insurance carrier for approximately \$332,000 related to business interruption for which the Company did not record a receivable. Insurance proceeds for reimbursements related to business interruptions are considered gain contingencies and are not recognized in the financial statements until the period in which all contingencies are resolved and the gain is realized. During the fourth quarter of fiscal year 2015, the Company expensed to cost of goods sold, net warehouse club expenses of approximately \$165,000 related to the write off of inventory not covered by insurance. Additionally, the Company expensed to selling, general and administrative expenses approximately \$34,000 in salaries related to the clean up and preparation of the warehouse club for reopening.

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

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

Vendor consideration consists primarily of volume rebates, time-limited product promotions, slotting fees, demonstration reimbursements and prompt payment discounts. Volume rebates that are not threshold-based are incorporated into the unit cost of merchandise, reducing the inventory cost and cost of goods sold. Volume rebates that are threshold-based are recorded as a reduction to cost of goods sold when the Company achieves established purchase levels that are confirmed by the

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

vendor in writing or upon receipt of funds. On a quarterly basis, the Company calculates the amount of rebates recorded in cost of goods sold that relates to inventory on hand and this amount is reclassified as a reduction to inventory. Product promotions are generally linked to coupons that provide for reimbursement to the Company from the vendor of the product being promoted. Slotting fees are related to consideration received by the Company from vendors for preferential "end cap" placement of the vendor's products within the warehouse club. Demonstration reimbursements are related to consideration received by the Company from vendors for the in-store promotion of the vendors' products. The Company records the reduction in cost of goods sold on a transactional basis for these programs. Prompt payment discounts are taken in substantially all cases, and therefore are applied directly to reduce the acquisition cost of the related inventory, with the resulting effect recorded to cost of goods sold when the inventory is sold.

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

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

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

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

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

The following table summarizes the amounts recorded for the three and nine months ended May 31, 2016 and 2015 (in thousands):

	Three Months		Nine Months Ended	
	Ended May 31, 2016	May 31, 2015	May 31, 2016	May 31, 2015
Currency gain (loss)	\$ (222)	\$ (311)	\$ (1,018)	\$ (4,602)

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.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

The Company accrues an amount for its estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained. This requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. When facts and circumstances change, the Company reassesses these probabilities and records any changes in the consolidated financial statements as appropriate. There were no material changes in the Company's uncertain income tax positions as of May 31, 2016 and August 31, 2015. During the first quarter of fiscal year 2015, one of the Company's subsidiaries received provisional assessments claiming \$2.5 million of taxes, penalties and interest related to withholding taxes on certain charges for services rendered by the Company. In addition, this subsidiary received provisional assessments totaling \$5.2 million for lack of deductibility of the underlying service charges due to the lack of withholding. Based on a review of the Company's tax advisers' interpretation of local law, rulings and jurisprudence (including Supreme Court precedents with respect to the deductibility assessment), the Company expects to prevail in both instances and has not recorded a provision for these assessments. Also, in another country, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires the Company to pay taxes based on a percentage of sales rather than income. As a result, the Company is making income tax payments substantially in excess of those it would expect to pay based on taxable income. The current rules (which the Company has challenged in court) do not clearly allow the Company to obtain a refund or offset this excess income tax against other taxes. As of May 31, 2016, the Company had deferred tax assets of approximately \$1.7 million in this country. Also, the Company had an income tax receivable balance of \$2.2 million as of May 31, 2016 related to excess payments from fiscal years 2015 and 2016. The Company has not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets, because the Company believes that it is more likely than not that it will succeed in its refund request and/or court challenge on this matter.

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

Edgar Filing: PRICESMART INC - Form 10-Q

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

	Three Months		Nine Months	
	Ended		Ended	
	May 31,	May 31,	May 31,	May 31,
	2016	2015	2016	2015
Federal tax provision at statutory rates	35.0 %	35.0 %	35.0 %	35.0 %
State taxes, net of federal benefit	0.3	0.3	0.3	0.4
Differences in foreign tax rates	(5.0)	(4.7)	(5.0)	(4.3)
Permanent items and other adjustments	2.1	1.6	1.6	2.4
Increase (decrease) in foreign valuation allowance	2.8	1.5	1.5	1.8
Provision for income taxes	35.2 %	33.7 %	33.4 %	35.3 %

The variance in the effective tax rate for the three months ended May 31, 2016 compared to the same period of the prior year was primarily attributable to the unfavorable impact of 1.9% resulting from an increased taxable loss incurred in the Company's Colombia subsidiary for which no tax benefit was recognized, net of adjustment to valuation allowance, and the favorable impact of 0.7% due to the relative decrease in U.S. taxable income, which is taxed at a higher statutory tax rate compared to tax rates in foreign jurisdictions.

The variance in the effective tax rate for the nine months ended May 31, 2016 compared to the prior year was primarily attributable to the favorable impact of 1.0% resulting from a decreased taxable loss incurred in the Company's Colombia subsidiary for which no tax benefit was recognized, net of adjustment to valuation allowance, and the favorable impact of 0.6% due to the relative decrease in U.S. taxable income, which is taxed at a higher statutory tax rate compared to tax rates in foreign jurisdictions.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Recent Accounting Pronouncements

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

In March, 2016, the Financial Accounting Standards Board (“FASB”) issued amendments to the guidance on employee share-based payment accounting intended to improve the accounting for employee share-based payments. This ASU simplifies several aspects of the accounting for share-based payment award transactions, including:

- The income tax consequences
- Classification of awards as either equity or liabilities, and
- Classification on the statement of cash flows

The amendments in this ASU are effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted for any organization in any interim or annual period. 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 amendments to the guidance on lease accounting. Under the new guidance, for all leases longer than 12 months, a lessee will be required to record a lease liability for all payments arising from a lease and also record a right of use asset for the term of the lease. Under the new guidance lessor accounting is largely unchanged.

The amendment in this ASU is effective on a prospective or retrospective basis for public entities for fiscal years and interim periods within those annual periods beginning after December 15, 2018. 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 740 ASU 2015-17 -Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes

In November 2015, the FASB issued amended guidance eliminating the requirement for organizations to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, organizations will be required to classify all deferred tax assets and liabilities as noncurrent.

The amendment in this ASU is effective on a prospective or retrospective basis for public entities for fiscal years and interim periods within those annual periods beginning after December 15, 2016. Early adoption is allowed. The Company has elected early adoption of this amendment to the guidance. The Company has re-classified all deferred tax assets and liabilities as noncurrent. See Note 1 for details.

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. Early application is permitted as of the beginning of an interim or annual reporting period. Adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

FASB ASC 350 ASU 2015-05 - Customers Accounting for Fees Paid in a Cloud Computing Arrangement

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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

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

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

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

NOTE 3 – PROPERTY AND EQUIPMENT

Edgar Filing: PRICESMART INC - Form 10-Q

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

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

	May 31, 2016	August 31, 2015
Land	\$ 131,073	\$ 128,071
Building and improvements	297,569	278,982
Fixtures and equipment	183,858	164,916
Construction in progress	34,780	26,679
Total property and equipment, historical cost	647,280	598,648
Less: accumulated depreciation	(190,696)	(165,608)
Property and equipment, net	\$ 456,584	\$ 433,040

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Depreciation and amortization expense (in thousands):

	Three Months Ended		Nine Months Ended	
	May 31, 2016	May 31, 2015	May 31, 2016	May 31, 2015
Depreciation and amortization expense	\$ 10,271	\$ 8,740	\$ 29,003	\$ 25,173

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

Total interest capitalized (in thousands):

	Balance as of	
	May 31, 2016	August 31, 2015
Total interest capitalized	\$ 7,318	\$ 6,961

Total interest capitalized (in thousands):

	Three Months Ended May 31,May 31, 2016 2015		Nine Months Ended May 31,May 31, 2016 2015	
Interest capitalized	\$ 146	\$ 148	\$ 580	\$ 911

The Company also recorded within accounts payable and other accrued expenses approximately \$777,000 and \$1.7 million as of May 31, 2016 and \$458,000 and \$1.5 million as of August 31, 2015 of liabilities related to the acquisition and/or construction of property and equipment, respectively.

NOTE 4 – EARNINGS PER SHARE

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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table sets forth the computation of net income per share for the three and nine months ended May 31, 2016, (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	May 31, 2016	May 31, 2015	May 31, 2016	May 31, 2015
Net income	\$ 16,837	\$ 21,195	\$ 66,451	\$ 66,677
Less: Allocation of income to unvested stockholders	(288)	(257)	(1,041)	(856)
Net earnings available to common stockholders	\$ 16,549	\$ 20,938	\$ 65,410	\$ 65,821
Basic weighted average shares outstanding	29,951	29,883	29,918	29,834
Add dilutive effect of stock options (two-class method)	4	5	5	7
Diluted average shares outstanding	29,955	29,888	29,923	29,841
Basic net income per share	\$ 0.55	\$ 0.70	\$ 2.19	\$ 2.20
Diluted net income per share	\$ 0.55	\$ 0.70	\$ 2.19	\$ 2.20

NOTE 5 – STOCKHOLDERS' EQUITY

Dividends

The following table summarizes the dividends declared and paid during fiscal year 2016 and 2015:

Declared	Amount	First Payment			Amount	Second Payment			Amount
		Record Date	Date Paid	Date Payable		Record Date	Date Paid	Date Payable	
2/3/2016	\$ 0.70	2/15/2016	2/29/2016	N/A	\$ 0.35	8/15/2016	N/A	8/31/2016	\$ 0.35
2/4/2015	\$ 0.70	2/13/2015	2/27/2015	N/A	\$ 0.35	8/14/2015	8/31/2015	N/A	\$ 0.35

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

Comprehensive Income and Accumulated Other Comprehensive Loss

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

	Nine Months Ended May 31, 2016			
	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments	Total
Beginning balance, September 1, 2015	\$ (100,540)	\$ (113)	\$ (859)	\$ (101,512)
Other comprehensive income (loss)	(4,383)	—	(522)	(4,905)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(14)	(2)	(14)
Ending balance, May 31, 2016	\$ (104,923)	\$ (127)	\$ (1,381)	\$ (106,431)

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Nine Months Ended May 31, 2015			
	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments	Total
Beginning balance, September 1, 2014	\$ (50,410)	\$ 113	\$ 1,011	\$ (49,286)
Other comprehensive income (loss)	(24,241)	—	3,506	(20,735)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(35)	(2)	(35)
Ending balance, May 31, 2015	\$ (74,651)	\$ 78	\$ 4,517	\$ (70,056)

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

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

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

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

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):

	May 31, 2016	August 31, 2015
Retained earnings not available for distribution	\$ 5,816	\$ 5,479

NOTE 6 – STOCK BASED COMPENSATION

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

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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

The following table summarizes the shares authorized and shares available for future grants:

		Shares available to grant	
		May 31, 2016	August 31, 2015
	Shares authorized for issuance as of May 31, 2016 (including shares originally authorized for issuance under prior plans)		
2013 Plan	944,905	617,850	847,876

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

	Three Months Ended		Nine Months Ended	
	May 31, 2016	May 31, 2015	May 31, 2016	May 31, 2015
Options granted to directors	\$ 20	\$ 25	\$ 53	\$ 61

Edgar Filing: PRICESMART INC - Form 10-Q

Restricted stock awards	1,618	929	5,295	3,633
Restricted stock units	515	328	1,383	928
Stock-based compensation expense	\$ 2,153	\$ 1,282	\$ 6,731	\$ 4,622

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

	Balance as of	
	May 31,	May 31,
	2016	2015
Remaining unrecognized compensation cost (in thousands)	\$ 33,383	\$ 19,005
Weighted average period of time over which this cost will be recognized (years)	4	5

	Nine Months	
	Ended	
	May 31,	May 31,
	2016	2015
Excess tax benefit (deficiency) on stock-based compensation (in thousands)	\$ 579	\$ 1,220

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

	Nine Months Ended	
	May 31,	May 31,
	2016	2015
Grants outstanding at beginning of period	366,021	488,416
Granted	258,133	27,607
Forfeited	(747)	(9,618)
Vested	(87,090)	(142,370)
Grants outstanding at end of period	536,317	364,035

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

	Nine Months Ended	
	May 31, 2016	May 31, 2015
Weighted Average Grant Date Fair Value		
Restricted stock awards and units granted	\$ 84.70	\$ 89.64
Restricted stock awards and units vested	\$ 63.64	\$ 44.42
Restricted stock awards and units forfeited	\$ —	\$ 64.13

	Nine Months Ended	
	May 31, 2016	May 31, 2015
Total fair market value of restricted stock awards and units vested (in thousands)	\$ 6,462	\$ 12,624

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

	Nine Months Ended	
	May 31, 2016	May 31, 2015
Shares repurchased	27,360	50,639
Cost of repurchase of shares (in thousands)	\$ 2,017	\$ 4,500

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

	Nine Months Ended May 31, 2016 2015	
Reissued treasury shares	—	—

The following table summarizes the stock options outstanding:

	May 31, 2016	August 31, 2015
Stock options outstanding	16,000	20,000

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

NOTE 7 – COMMITMENTS AND CONTINGENCIES

Legal Proceedings

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

year could be impacted by changes in circumstances relating to such matters.

24

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Taxes

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

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

In evaluating the exposure associated with various non-income tax filing positions, the Company accrues for probable and estimable exposures for non-income tax related tax contingencies. As of May 31, 2016 and August 31, 2015, the Company has recorded within other accrued expenses a total of \$4.4 million and \$4.1 million, respectively, for various non-income tax related tax contingencies.

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

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

Other Commitments

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

Years ended May 31,	Open Locations ⁽¹⁾
2017	\$ 10,982
2018	11,234
2019	10,907
2020	10,428
2021	9,141
Thereafter	62,841
Total	\$ 115,533

⁽¹⁾ Operating lease obligations have been reduced by approximately \$236,000 to reflect sub-lease income. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.

The Company is also committed to non-cancelable construction services obligations for various warehouse club developments and expansions. As of May 31, 2016 and August 31, 2015, these commitments were approximately \$5.2 million and \$12.3 million, respectively, 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 the balance sheet deposits of approximately \$642,000. These land purchase option agreements can be canceled at the sole option of the Company, with the Company forfeiting the deposit. 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 review. The Company's due diligence review includes evaluations of the legal status of the property,

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 these purchase option agreements are exercised, the cash use would be approximately \$16.9 million.

In March 2016, the Company entered into a contract, subject to customary contingencies, to acquire a build-to-suit distribution center in Miami-Dade County, Florida, to which it will transfer the majority of its current Miami distribution center activities once the construction of the building is complete and the building is ready for occupancy. The Company currently expects construction to be completed in the first half of calendar year 2017. The total purchase price is approximately \$46.0 million. During March 2016, the Company deposited into escrow \$300,000 of cash and approximately \$8.8 million through an irrevocable and unconditional standby letter of credit payable to the seller. This letter of credit also contains an automatic one year renewal and entitles the seller to draw upon this letter of credit fully or partially on demand if the seller, per the underlying build-to-suit purchase contract, is entitled to draw down upon the letter of credit under prescribed conditions.

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

The Company contracts for distribution center services in Mexico. The contract for this distribution center's services expires on August 31, 2017, with the applicable fees and rates to be reviewed at the beginning of each calendar year. Future minimum service commitments related to this contract through the end of the contract term are approximately \$207,000.

NOTE 8 – DEBT

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

	Total Amount of Facilities	Facilities Used		Facilities Available	Weighted average interest rate	
		Short-term of Borrowings	Letters Credit			
May 31, 2016	\$ 64,993	\$ 10,127	\$ 9,258	\$ 45,608	6.7	%
August 31, 2015	\$ 57,691	\$ 6,606	\$ 728	\$ 50,357	5.9	%

As of May 31, 2016 and August 31, 2015, the Company had approximately \$40.0 million of short-term facilities in the U.S. that require compliance with certain quarterly financial covenants. As of May 31, 2016 and August 31, 2015, 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 nine months ended May 31, 2016:

(Amounts in thousands)	Current	Long-term	Total
	portion of long-term debt	debt (net of current portion)	
Balances as of August 31, 2015	\$ 17,169	\$ 73,365	\$ 90,534 (1)
Proceeds from long-term debt incurred during the period:			
Costa Rica subsidiary	—	7,370	7,370
Repayments of long-term debt:			
Regularly scheduled loan payments	(553)	(9,638)	(10,191)
Reclassifications of long-term debt	(731)	731	—
Translation adjustments on foreign-currency debt of subsidiaries whose functional currency is not the U.S. dollar (2)	214	(366)	(152)
Balances as of May 31, 2016	\$ 16,099	\$ 71,462	\$ 87,561 (3)

(1) The carrying amount on non-cash assets assigned as collateral for this total was \$104.1 million. No cash assets were assigned as collateral for this total.

(2) These foreign currency translation adjustments are recorded within Other comprehensive income.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(3) The carrying amount on non-cash assets assigned as collateral for this total was \$100.0 million. No cash assets were assigned as collateral for this total.

As of May 31, 2016, the Company had approximately \$75.0 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 May 31, 2016, the Company was in compliance with all covenants or amended covenants.

As of August 31, 2015, the Company had approximately \$85.0 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, 2015, 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 May 31,	Amount
2017	\$ 15,619
2018	12,967
2019	24,378
2020	21,811
2021	6,068
Thereafter	2,997
Total (1)	\$ 83,840

(1) In the case of loans subject to cross-currency interest rate swaps, the Company has used the effective rate to the Company under the applicable derivative obligation as of May 31, 2016 to disclose the future commitments of the related long-term debt.

NOTE 9 – 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 effective portion of the gain or loss on the derivative reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction is determined to be ineffective. There were no such amounts recorded for ineffectiveness for the periods reported herein related to the interest rate or cross-currency interest rate swaps of long-term debt.

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.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Cash Flow Hedges

As of May 31, 2016, 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.

The following table summarizes agreements for which the Company has recorded cash flow hedge accounting transactions during the nine months ended May 31, 2016:

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
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	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 and December beginning on June 24, 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 on 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, September, December beginning on March 4, 2015

Edgar Filing: PRICESMART INC - Form 10-Q

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 3.5%	5.16 %	28th day of each month beginning December 29, 2014
Honduras	23-Oct-14	Citibank, N.A. ("Citi")	Cross currency interest rate swap	\$ 5,000,000	Citibank, N.A.	Variable rate 3-month Libor plus 3.5%	11.60 %	22nd day of January, April, July, and October beginning on January 22, 2014
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 beginning September 22, 2014
Panama	22-May-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 19,800,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.98 %	4th day of each month beginning June 4, 2014
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 beginning June 4, 2014

For the three and nine months ended May 31, 2016 and 2015, 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 May 31, 2016	\$ 812	\$ 461	\$ 1,273
Interest expense for the three months ended May 31, 2015	\$ 644	\$ 837	\$ 1,481
Interest expense for the nine months ended May 31, 2016	\$ 2,377	\$ 1,478	\$ 3,855
Interest expense for the nine months ended May 31, 2015	\$ 1,577	\$ 2,063	\$ 3,640

⁽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.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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):

	May 31, 2016	August 31, 2015
Floating Rate Payer (Swap Counterparty)		
Scotiabank	\$ 33,558	\$ 37,458
Citibank N.A.	31,213	34,287
Total	\$ 64,771	\$ 71,745

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	May 31, 2016			August 31, 2015		
		Fair Value	Net Tax Effect	Net OCI	Fair Value	Net Tax Effect	Net OCI
Cross-currency interest rate swaps(1)	Other non-current assets	\$ 3,889	\$ (236)	\$ (3,653)	\$ 4,129	\$ (1)	\$ (4,128)
Interest rate swaps	Other long-term liabilities	(448)	125	323	(387)	98	289
Cross-currency interest rate swaps	Other long-term liabilities	(1,236)	371	865	(1,312)	482	830
Net fair value of derivatives designated as hedging instruments		\$ 2,205	\$ 260	\$ (2,465)	\$ 2,430	\$ 579	\$ (3,009)

(1) The beneficial tax effect of these swaps is largely offset by a valuation allowance.

The Company did not settle any derivatives during the nine months ended May 31, 2016. The following table summarizes the derivatives that were settled during the twelve months ended August 31, 2015 (in thousands, except footnote data):

Date	Payment of Derivative Obligation	Foreign Exchange on Derivative Obligation	Recognize Settlement of Derivative Right net of Bank Fees	Swap Derivative (Gain)Loss	
23-Jul-15	\$ 5,141	\$ 2,929	\$ (2,859)	\$ 50	
31-Jul-15	1,343	670	(657)	11	
31-Jul-15	4,029	2,011	(1,971)	21	
6-Aug-15	4,944	3,181	(3,056)	70	
	\$ 15,457	\$ 8,791	\$ (8,543)	\$ 152	(1)

(1) Reclassified from accumulated other comprehensive income (loss) to other income (expense) for settlement of derivative instruments in the amount of \$100,000, net of tax.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Fair Value Instruments

The Company has entered 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. The Company did not enter into any non-deliverable forward foreign exchange contracts during the nine months ended May 31, 2016. The following table summarizes the non-deliverable forward foreign exchange contracts that the Company entered during the twelve months ended August 31, 2015:

Subsidiary	Dates entered into	Derivative Financial Counter-party	Derivative Financial Instrument	Notional Amount (in thousands)	Settlement Date	Effective Period of Forward
Costa Rica	31-Aug-15	Citibank, N.A.	Forward foreign exchange contracts	\$ 3,750	August 30, 2016	August 31, 2015-August 30, 2016

For the three and nine months ended May 31, 2016 and 2015, 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		Nine Months Ended	
	May 31, 2016	May 31, 2015	May 31, 2016	May 31, 2015
Other income (expense), net	\$ 23	\$ 465	\$ (128)	\$ 6,599

The following table summarizes the fair value of foreign currency forward contracts that do not qualify for derivative hedge accounting (in thousands):

Derivatives designated as fair value hedging instruments	May 31, 2016		August 31, 2015	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Foreign currency forward contracts	Other accrued expenses	\$ (192)	Other accrued expenses	\$ (66)
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting		\$ (192)		\$ (66)

NOTE 10 – UNCONSOLIDATED AFFILIATES

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.

In 2008, the Company entered into real estate joint ventures to jointly own and operate separate commercial retail centers adjacent to warehouse clubs in Panama (Golf Park Plaza, S.A.) and Costa Rica (Plaza Alajuela, S.A.). Due to the initial 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.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On December 12, 2013, the Company entered into a lease agreement for approximately 17,976 square feet (1,670 square meters) of land with Golf Park Plaza, S.A. upon which the Company constructed its central offices in Panama. Construction of the offices was completed in October 2014. The lease term is for 15 years with three options to renew for five years each at the Company's discretion. For the three and nine months ended May 31, 2016 and May 31, 2015, the Company recognized rent expense of \$26,400 and \$79,200, respectively.

On December 11, 2015, the Company's joint venture Golf Park Plaza, S.A. ("GPP") transferred final ownership of land to OD Panama, S.A. ("ODP"), which is operated by Office Depot Mexico, S.A. de C.V., following its execution of the related purchase option. The deed was recorded with the relevant agencies in Panama during February 2016. ODP had on July 15, 2011 (fiscal year 2011), entered into a 30 year operating lease, with an option to buy, for approximately 26,000 square feet of land owned by GPP. The option to purchase the land had a three-year limit beginning in April 2013. As part of this transaction, ODP: (i) made an initial deposit to GPP in the sum of approximately \$545,000 at the time of signing the agreement; (ii) paid a second deposit of approximately \$436,000 at the time its building was completed and its store opened to the public; (iii) paid monthly rent per the lease clause of the agreement which the Company recognized on a straight line basis; and (iv) contracted to pay an additional \$109,000, less rental payments of \$39,000 previously applied per the lease clause, when ODP exercised its option to purchase the land. ODP opened its store in April of 2013. GPP recorded rental income on a straight line basis for approximately \$106,000, \$72,000 and \$12,000 during the fiscal years ended August 31, 2015, 2014 and 2013, respectively. During fiscal year 2016 GPP recorded rental income for approximately \$1,000. GPP recorded a gain, net of tax, on the sale of the land for approximately \$851,000 during February 2016. Gonzalo Barrutieta, who is a director of the Company, is also a member of the Board of Directors of Office Depot Mexico, S.A. de C.V., which operates ODP.

The table below summarizes the Company's interest in these VIEs and the Company's maximum exposure to loss as a result of its involvement with these VIEs as of May 31, 2016 (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	\$ 330	\$ 7,348	\$ 99	\$ 7,447
Price Plaza Alajuela, S.A.	50 %	2,193	1,236	21	3,450	785	4,235
Total		\$ 6,809	\$ 3,638	\$ 351	\$ 10,798	\$ 884	\$ 11,682

- (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 summarized financial information of the unconsolidated affiliates is as follows (in thousands):

	May 31, 2016	August 31, 2015
Current assets	\$ 607	\$ 432
Noncurrent assets	\$ 11,858	\$ 12,157
Current liabilities	\$ 243	\$ 1,120
Noncurrent liabilities	\$ 15	\$ 11

	Three Months Ended May 31, May 31, 2016 2015		Nine Months Ended May 31, May 31, 2016 2015	
Net income (loss)	\$ (13)	\$ 63	\$ 362	\$ 90

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 11 – SEGMENTS

The Company and its subsidiaries are principally engaged in the international operation of membership shopping in 38 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.

Prior to fiscal year 2015, the Company's operating segments were the United States, Latin American and the Caribbean. During the second quarter of fiscal year 2015, the Company created a new operating segment comprised of its Colombia Operations and separated the Colombia Operations from the Latin America Operations, renaming that segment Central America Operations. The Company has made this change as a result of the information that the Company's senior operating management regularly reviews for purposes of allocating resources and assessing performance and the growing level of investment and sales activity in Colombia. Therefore, beginning in the second quarter of fiscal year 2015, the Company has reported its financial performance based on these new segments and retrospectively adopted this change for the disclosure of financial information presented by segment. This presentation more closely reflects the information reviewed by the Company's chief operating decision maker.

The Company also early adopted ASU 2015-17 retrospectively, as of the second quarter of fiscal year 2016. Accordingly, the Company reclassified current deferred tax assets and liabilities to noncurrent on its consolidated balance sheet reported for fiscal year ended 2015.

The following table summarizes the impact of this reclassifications on segment reporting:

Edgar Filing: PRICESMART INC - Form 10-Q

	United	Central				
	States	American	Caribbean	Colombia	Reconciling	
	Operations	Operations	Operations	Operations	Items	Total
As of May 31, 2015						
Total assets as previously reported	\$ 86,224	\$ 501,021	\$ 222,928	\$ 206,010	\$ —	\$ 1,016,183
Reclassification of deferred tax liabilities short term and long term to deferred tax assets long term	(35)	—	(655)	(50)	—	(740)
Total assets as currently reported	\$ 86,189	\$ 501,021	\$ 222,273	\$ 205,960	\$ —	\$ 1,015,443
As of August 31, 2015						
Total assets as previously reported	\$ 89,167	\$ 491,548	\$ 239,311	\$ 171,666	\$ —	\$ 991,692
Reclassification of deferred tax liabilities short term and long term to deferred tax assets long term	(34)	(393)	(39)	(2)	—	(468)
Total assets as currently reported	\$ 89,133	\$ 491,155	\$ 239,272	\$ 171,664	\$ —	\$ 991,224

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 May 31, 2016						
Revenue from external customers	\$ 7,108	\$ 431,001	\$ 200,041	\$ 66,112	\$ —	\$ 704,262
Intersegment revenues	249,639	—	1,665	—	(251,304)	—
Depreciation and amortization	1,391	4,823	2,436	1,621	—	10,271
Operating income	3,479	30,898	11,484	(1,642)	(16,730)	27,489
Net income	714	24,999	9,886	(2,032)	(16,730)	16,837
Capital expenditures, net	831	6,760	2,631	9,976	—	20,198
Nine Months Ended May 31, 2016						
Revenue from external customers	\$ 21,924	\$ 1,329,485	\$ 641,739	\$ 200,976	\$ —	\$ 2,194,124
Intersegment revenues	809,301	—	4,429	—	(813,730)	—
Depreciation and amortization	3,352	13,634	7,285	4,732	—	29,003
Operating income	14,141	103,587	39,732	(3,674)	(49,866)	103,920
Net income	4,032	82,634	34,789	(5,138)	(49,866)	66,451
Capital expenditures, net	4,158	22,438	8,381	18,972	—	53,949
Long-lived assets (other than deferred tax assets)	16,242	269,383	109,145	123,501	—	518,271
Goodwill	—	31,082	4,570	—	—	35,652
Total assets	85,933	511,530	286,477	165,883	—	1,049,823
Three Months Ended May 31, 2015						
Revenue from external customers	\$ 9,483	\$ 403,070	\$ 201,101	\$ 83,449	\$ —	\$ 697,103
Intersegment revenues	248,635	—	1,516	—	(250,151)	—
Depreciation and amortization	527	3,790	2,408	2,015	—	8,740
Operating income	4,257	31,932	11,928	18	(14,617)	33,518
Net income	1,013	25,403	9,975	(579)	(14,617)	21,195

Edgar Filing: PRICESMART INC - Form 10-Q

Capital expenditures, net	701	16,613	2,503	9,865	—	29,682
Nine Months Ended May 31, 2015						
Revenue from external customers	\$ 24,149	\$ 1,212,461	\$ 619,717	\$ 247,094	\$ —	\$ 2,103,421
Intersegment revenues	846,574	—	4,406	—	(850,980)	—
Depreciation and amortization	1,614	11,132	7,147	5,280	—	25,173
Operating income	19,971	100,186	37,505	(1,763)	(44,388)	111,511
Net income	7,994	78,577	31,808	(7,314)	(44,388)	66,677
Capital expenditures, net	(740)	(2) 39,844	7,365	27,083	—	73,552
Long-lived assets (other than deferred tax assets)	14,166	250,384	107,429	126,200	—	498,179
Goodwill	—	31,283	4,681	—	—	35,964
Total assets	86,189	501,021	222,273	205,960	—	1,015,443
As of August 31, 2015						
Long-lived assets (other than deferred tax assets)	\$ 15,391	\$ 255,576	\$ 107,746	\$ 105,290	\$ —	\$ 484,003
Goodwill	—	31,211	4,660	—	—	35,871
Total assets	89,133	491,155	239,272	171,664	—	991,224

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

(2) The decrease in capital expenditures is a result of the transfers of capital assets from this segment to other segments.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 12 – SUBSEQUENT EVENTS

The Company has evaluated all events subsequent to the balance sheet date of May 31, 2016 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.

Financing Transactions

On June 8, 2016, the Company's Trinidad subsidiary entered into a loan agreement with First Caribbean International Bank (“FCIB”). The agreement was made supplemental to the outstanding loan facility agreement between the same parties. The amount outstanding under the original loan was approximately \$2.8 million as of May 31, 2016. The agreement provides for a US \$7.0 million loan to be repaid in 60 monthly principal payments plus interest, and balloon payment of \$2.0 million due on the repayment date. The interest rate is set at the 90 day LIBOR rate plus 2.75%. The \$7.0 million loan was funded and the pre-existing \$2.8 million dollar loan was paid in full on June 8, 2016.

On June 9, 2016 the Company's Trinidad subsidiary paid down approximately \$4.1 million in short-term facilities loans outstanding with Citibank.

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 the following risks: our financial performance is dependent on international operations, which exposes us to various risks; any failure by us to manage our widely dispersed operations could adversely affect our business; we face significant competition; future sales growth depends on our ability to successfully open new warehouse clubs and grow sales in our existing locations; we might not identify in a timely manner or effectively respond to changes in consumer preferences for merchandise, which could adversely affect our relationship with members, demand for our products and market share; although we have begun to offer limited online shopping to our members, our sales could be adversely affected if one or more major international online retailers were to enter our markets or if other competitors were to offer a superior online experience; our profitability is vulnerable to cost increases; we face difficulties in the shipment of and inherent risks in the importation of, merchandise to our warehouse clubs; we are exposed to weather and other natural disaster risks; general economic conditions could adversely impact our business in various respects; we are subject to risks associated with possible changes in our relationships with third parties with which we do business, as well as the performance of such third parties; we rely extensively on computer systems to process transactions, summarize results and manage our business, and failure to adequately maintain our systems and disruptions in our systems could harm our business and adversely affect our results of operations; we could be subject to additional tax liabilities; a few of our stockholders own approximately 26.0% of our voting stock as of May 31, 2016, which may make it difficult to complete some corporate transactions without their support and may impede a change in control; failure to attract and retain qualified employees, increases in wage and benefit costs, changes in laws and other labor issues could materially adversely affect our financial performance; we are subject to volatility in foreign currency exchange rates; we face the risk of exposure to product liability claims, a product recall and adverse publicity; any failure to maintain the security of the information relating to our company, members, employees and vendors that we hold, whether as a result of cybersecurity attacks on our information systems, failure of internal controls, employee negligence or malfeasance or otherwise, could damage our reputation with members, employees, vendors and others, could cause us to incur substantial additional costs and to become subject to litigation and could materially adversely affect our operating results; we are subject to payment related risks; changes in accounting standards and assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our financial condition and results of operations; we face increased public company compliance risks and compliance risks related to our international operations; and if remediation costs or hazardous substance contamination levels at certain properties for which we maintain financial responsibility exceed management's current expectations, our financial condition and results of operations could be adversely impacted. 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, 2015 filed on October 29, 2015 pursuant to the Securities Exchange Act of 1934, see "Part II - 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.

The following discussion and analysis compares the results of operations for the three and nine months ended May 31, 2016 and 2015 and should be read in conjunction with the consolidated financial statements and the accompanying notes included therein.

Table of Contents

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 May 31, 2016 is 100%, and they are presented on a consolidated basis. The number of warehouse clubs in operation as of May 31, 2016 for each country or territory are as follows:

Country/Territory	Number of Warehouse Clubs in Operation as of August 31, 2015	Number of Warehouse Clubs in Operation as of May 31, 2016	Anticipated warehouse club openings in fiscal year 2016	Anticipated warehouse club openings in fiscal year 2017
Colombia	6	6	—	1
Costa Rica	6	6	—	—
Panama	5	5	—	—
Trinidad	4	4	—	—
Dominican Republic	3	3	—	—
Guatemala	3	3	—	—
El Salvador	2	2	—	—
Honduras	3	3	—	—
Aruba	1	1	—	—
Barbados	1	1	—	—
U.S. Virgin Islands	1	1	—	—
Jamaica	1	1	—	—
Nicaragua	1	2	—	—
Totals	37	38	—	1

In 2014, we purchased land in Pereira and Medellin, Colombia and leased land in the city of Bogota, Colombia. We built new warehouse clubs on these three sites, opening the Bogota location in October 2014 and the Pereira and Medellin locations in November 2014. Together with the three warehouse clubs that were already operating in Colombia (one in Barranquilla and two in Cali), these three new clubs brought the number of operating PriceSmart warehouse clubs in Colombia to six. In September 2014, we acquired land in La Chorrera ("Costa Verde"), west of Panama City, Panama, on which we opened our fifth PriceSmart warehouse club in Panama in June 2015. In April 2015, we acquired land in Managua, Nicaragua. We constructed and then opened a warehouse club on this site in November 2015. We are currently constructing a new warehouse club on land acquired in May 2015 in Chia, Colombia which is expected to open in September 2016. On December 4, 2015 we signed an option to acquire two properties and then swap them for 59,353 square feet of land adjacent to our San Pedro Sula warehouse club in Honduras. We exercised this option and completed the swap during May 2016. We will use the acquired land to

expand the parking lot for the San Pedro Sula warehouse club.

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. During the second quarter of fiscal year 2015, the Company created a new operating segment comprised of its Colombia Operations and separated the Colombia Operations from the Latin America Operations, renaming that segment Central America Operations. The Company has made this change as a result of the information that the Company's senior operating management regularly reviews for purposes of allocating resources and assessing performance and the growing level of investment and sales activity in Colombia. Therefore, beginning in the second quarter of fiscal year 2015, the Company has reported its financial performance based on these new segments and retrospectively adopted this change for the disclosure of financial information presented by segment. The Company's operating segments are the United States, Central America, the Caribbean and Colombia.

General Market Factors

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

Our consolidated results of operations continue to be adversely affected by events in Colombia, resulting largely from a major decline in the value of the Colombian peso (COP) relative to the U.S. dollar occurring over the past 21 months. The devaluation not only reduces the value of sales and membership income that is generated in Colombia 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. This, along with the fact that we are still relatively new in the Colombia market, and the sophisticated level of competition in that market, has impacted sales and has resulted in lower operating

Table of Contents

income as a percentage of sales in Colombia compared to our other markets. Certain of our Central American and Caribbean markets have experienced some slowing of overall economic activity during the most recent three month period which may continue to impact the level of consumer spending in the coming months. In particular, Trinidad's economy, with its dependence on oil and gas exports as a major source of income and resulting government policy to manage its foreign exchange reserves, is reportedly in a period of negative overall economic growth with a corresponding impact on consumer spending.

Our capture of retail and wholesale sales can vary from market to market due to competition and the availability of other retail options for the consumer. 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 have limited upside sales opportunity 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 a larger upper and middle class consumer population.

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. In addition, if a major employer in a market reduces its work force, as has happened in the past in Aruba and Costa Rica, overall consumer spending can suffer.

Currency fluctuations can be the largest variable affecting our overall sales and profit performance, as we experienced in fiscal year 2015 and into the current fiscal year, as many of our markets are susceptible to foreign currency exchange rate volatility. Currency exchange rate changes either increase or decrease the cost to our subsidiaries of imported products purchased in U.S. dollars and priced in local currency. In the first nine months of fiscal year 2016, approximately 77.3% of our net warehouse sales were in currencies other than the U.S. dollar. Meanwhile, approximately 52% of net warehouse sales were comprised of sales of products we purchased in U.S. dollars that were sold in countries whose currencies were other than the U.S. dollar.

Currency exchange rate fluctuations affect our consolidated sales and membership income as local-currency-denominated sales are translated to U.S. dollars, which can impact year over year growth when measured in U.S. dollars compared to local currency growth rates. In addition, we revalue on a monthly basis all U.S. dollar-denominated monetary assets and liabilities within our markets that do not use the U.S. dollar as their functional currency. These monetary assets and liabilities include, but are not limited to, excess cash permanently

reinvested offshore, U.S. dollar-denominated long-term debt used to finance land acquisitions and the construction of warehouse clubs, and U.S. dollar-denominated accounts payable related to the purchase of merchandise. We report the gains or losses associated with the revaluation of these monetary assets and liabilities on our Consolidated Statements of Income under the heading "Other income (expense), net.

We seek to minimize the impact of negative foreign exchange fluctuations on our results by utilizing from time to time one or more of the following strategies: (1) adjusting prices on goods acquired in U.S. dollars on a periodic basis to maintain our target margins after taking into account changes in exchange rates and our competition; (2) obtaining local currency loans from banks within certain markets where it is economical to do so and where management believes the risk of devaluation and the level of U.S. dollar denominated liabilities warrants this action; (3) reducing the time between the acquisition of product in U.S. dollars and the settlement of that purchase in local currency; (4) maintaining a balance between assets held in local currency and in U.S. dollars; and (5) entering into cross-currency interest rate swaps and forward currency derivatives. We have local-currency-denominated long-term loans in Honduras and Guatemala and have employed cross-currency interest rate swaps in Colombia, Costa Rica and Honduras and forward currency derivatives in Costa Rica. Future volatility regarding currencies could have a material impact on our operations in future periods; however, there is no way to accurately forecast the impact of the change in rates on our future demand for imported products, reported sales or financial results.

Business Strategy

Our business strategy is to offer for sale to businesses and families a limited number of high-volume stock keeping units (SKU's) covering a wide range of products at the lowest possible prices. We charge an annual membership fee to our customers. These fees, combined with warehouse and distribution operating efficiencies and volume purchasing, enable us to operate our business on lower merchandise margins than conventional retail stores and wholesale suppliers. The combination of annual membership fees, operating efficiencies and low margins enable us to offer our members high quality merchandise at very competitive prices which, in turn, enhances the membership proposition.

Table of Contents

Current and Future Management Actions

Generally, our operating efficiencies, earnings and cash flow improve as sales increase. Higher sales provide greater purchasing power which often translates into lower cost of merchandise from our suppliers and lower prices for our members. Higher sales, coupled with continuous efforts to improve efficiencies through our distribution network and within our warehouse clubs, also give us the opportunity to leverage our operating costs and reduce prices for our members.

We seek to grow sales by increasing transaction size and shopping frequency and by providing high quality, differentiated merchandise at a good value. We also grow sales by attracting new members to our existing warehouse clubs and improving the capability and capacity of our existing warehouse clubs to serve the growing membership base and level of sales in those locations. Finally, sales growth is also achieved when we add new warehouse clubs in those markets that can support that growth. Sales during the third quarter and the first nine months of fiscal year 2016 were positively impacted by the three new warehouse clubs that opened in Colombia in the fall of 2014, another new warehouse club in Panama that opened in June 2015 and a new warehouse club in Nicaragua that opened in November 2015. Although we recognize that opening new warehouse club locations in certain existing markets can have adverse short-term implications for comparable store growth, as the new warehouse club will often attract sales from existing locations, each decision to add a location in an existing market is based on a long-term outlook. Overall, for the third quarter and first nine months of fiscal year 2016, net warehouse sales increased 1.4% and 4.4%, respectively, when compared to the same period a year ago.

One of the distinguishing features of the warehouse club format is the role membership plays both in terms of pricing and member loyalty. Membership fees are considered a component of overall gross margin and therefore allow us to reduce merchandise prices. In most of our markets, the annual membership fee is the equivalent of US \$35 for both business members and non-business “Diamond” members. In Colombia, the membership fee has been 65,000 (COP) (including VAT) since our initial entrance into the Colombian market. The Colombian peso (COP) was trading at approximately 2,000 COP to \$1.00 US dollar at that time. More recently, the Colombian peso has been trading above 3,000 COP to \$1.00 US dollar so that the converted membership price in U.S. dollars has gone from approximately \$30 to approximately \$20. We have not raised the Colombian peso price of membership in Colombia because our business is new and we want to avoid decisions that could negatively impact member satisfaction. In addition to the standard warehouse club membership, we offer in Costa Rica what we call Platinum membership for \$75. A Platinum membership earns a 2% rebate on annual purchases up to a maximum of \$500 rebate per year.

Logistics and distribution efficiencies are an important part of what allows us to deliver high quality merchandise at low prices to our members. About 50% of the Company’s sales are derived from merchandise acquired in local markets or regionally, with the remaining 50% of the merchandise acquired internationally and received and shipped primarily from our Miami distribution centers, 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. We have added local and regional distribution centers in several of our markets to improve merchandise flow and in-stock conditions and reduce operating costs, the benefit of which can be passed on to our members in the form of lower merchandise prices. These locations are generally leased, and the addition of new locations or expansion of current capacity will not require significant investment.

We offer our members alternatives to in-club shopping through our e-commerce platform which enables on-line access to purchase merchandise in different ways. Members have the ability to purchase certain merchandise that is not stocked in their local warehouse clubs and is shipped from our U.S. distribution warehouse for pick-up at the member's local warehouse club location. In some of our markets, members also can purchase in-club merchandise on-line from warehouse clubs located within the market and have it delivered to their home or office via a third-party delivery service. We have been expanding our online offerings, and while the percentage of sales through these channels relative to our overall sales is small, we believe it is an important and growing way to serve our current members and attract new members.

Purchasing land and constructing warehouse clubs is our single largest 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 real estate is highly dependent on real estate market conditions.

Table of Contents

With respect to our on-going actions in response to the devaluation of the Colombia peso, we are working to minimize the price increases and resulting impact on demand on imported items by (1) seeking ways to further reduce costs throughout the supply chain; (2) reducing our mark-ups (margins) for these items; (3) expanding our use of local suppliers, particularly with regard to private-label branded product; and (4) continuing to offer value and merchandise differentiation to our members. Ensuring long-term growth in the Colombia market is a key strategic priority. Therefore, we are prepared to accept lower merchandise margins and profits in Colombia in order to solidify our market position for the future. We believe these actions are having a positive effect as evidenced by continued new member sign-ups, improving membership renewal rates, and growth in average transaction value when measured in local currency. We remain committed to growing our presence in Colombia and are currently constructing a warehouse club in Chia, Colombia which will be our seventh club in that country when it opens in September 2016 – the most of any of our countries.

Financial highlights for the third quarter of fiscal year 2016 included:

- Net warehouse club sales increased 1.4% over the comparable prior year period. We ended the quarter with 38 warehouse clubs compared to 36 warehouse clubs at the end of the third quarter of fiscal year 2015. 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 May 29, 2016 decreased 2.8%.
- Membership income for the third quarter of fiscal year 2016 increased 2.6% to \$11.5 million.
- Warehouse gross profits (net warehouse club sales less associated cost of goods sold) in the quarter decreased (2.5)% over the prior year period and warehouse gross profits as a percent of net warehouse club sales were 13.7%, a decrease of 54 basis points (0.54%) from the same period last year.
- Operating income for the third quarter of fiscal year 2016 was \$27.5 million, a decrease of \$(6.0) million over the third quarter of fiscal year 2015.
- We had a \$(222,000) net loss from currency exchange transactions in the current quarter compared to a \$(311,000) net loss from currency exchange transactions in the same period last year.
- Net income for the third quarter of fiscal year 2016 was \$16.8 million, or \$0.55 per diluted share, compared to \$21.2 million, or \$0.70 per diluted share, in the comparable prior year period.

Financial highlights for the nine months ending May 31, 2016 included:

- Net warehouse club sales increased 4.4% over the comparable prior year period. 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 39 weeks ended May 29, 2016 decreased 0.8%.
- Membership income for the first nine months of fiscal year 2016 increased 6.3% to \$34.2 million.
- Warehouse gross profits as a percent of net warehouse club sales were 14.2%, a decrease of 52 basis points (0.52%) from the same period last year.

Operating income for the first nine months of fiscal year 2016 was \$103.9 million, a decrease of \$(7.6) million over the same nine-month period of fiscal year 2015.

- We had a \$(1.0) million net loss from currency exchange transactions in the first nine months of fiscal year 2016 compared to a \$(4.6) million net loss from currency exchange transactions in the same period last year.
- Net income for the first nine months of fiscal year 2016 was \$66.5 million, or \$2.19 per diluted share, compared to \$66.7 million, or \$2.20 per diluted share, in the comparable prior year period.

COMPARISON OF THE THREE AND NINE MONTHS ENDED MAY 31, 2016 AND 2015

The following discussion and analysis compares the results of operations for the three-month and nine-month periods ended on May 31, 2016 with the three-month and nine-month periods ended on May 31, 2015 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 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 nine months ended May 31, 2016 and May 31, 2015.

	Three Months Ended May 31, 2016			Increase/ (decrease) from prior year				Change		May 31, 2015		
	Amount	% of net sales	%					Amount	% of net sales	%		
Central America	\$ 423,101	61.8	%	\$ 27,478	6.9	%		\$ 395,623	58.6	%		
Caribbean	196,750	28.7	%	(1,381)	(0.7)	%		198,131	29.3	%		
Colombia	64,696	9.5	%	(16,864)	(20.7)	%		81,560	12.1	%		
Net warehouse club sales	\$ 684,547	100.0	%	\$ 9,233	1.4	%		\$ 675,314	100.0	%		

	Nine Months Ended May 31, 2016			Increase/ (decrease) from prior year				Change		May 31, 2015		
	Amount	% of net sales	%					Amount	% of net sales	%		

Edgar Filing: PRICESMART INC - Form 10-Q

				prior year					
Central America	\$ 1,305,539	61.2 %		\$ 114,910	9.7 %	\$ 1,190,629	58.2 %		
Caribbean	632,305	29.6 %		21,310	3.5 %	610,995	29.9 %		
Colombia	196,521	9.2 %		(45,704)	(18.9)%	242,225	11.9 %		
Net warehouse club sales	\$ 2,134,365	100.0 %		\$ 90,516	4.4 %	\$ 2,043,849	100.0 %		

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

Net warehouse sales growth in Central America was positively impacted by the openings of two new warehouse clubs, one in Panama (June 2015) and one in Nicaragua (November 2015) for both the three- and nine-month periods. All other Central American countries without additional warehouse clubs also recorded positive sales growth in the three or nine-month periods.

The Caribbean segment had no new warehouse clubs opened in the comparable periods. A significant increase in the number of products subject to Value Added Taxes starting in February in Trinidad and currency devaluations in both Trinidad and the Dominican Republic (the Company's two largest markets in the Caribbean segment) resulted in a negative sales growth in the quarter compared to the same period last year. For the nine-month period net warehouse sales increased 3.5%.

Net warehouse sales in Colombia were significantly impacted in the quarter by the devaluation of the Colombian peso relative to the U.S. dollar. The strength of the U.S. dollar causes the price of imported merchandise to increase in Colombian pesos, which reduces sales volumes of those products. In addition, net warehouse sales made in Colombian pesos when translated yielded 21% fewer U.S. dollars in the quarter and 33% fewer U.S. dollars for the nine month period compared to the year ago periods. Net warehouse sales in local currency (COP) for the third quarter of fiscal year 2016 declined 3.8%. For the nine-month period, net warehouse sales in COP grew 7.7%, reflecting the addition of three new warehouse clubs for the first quarter of fiscal year 2016 compared to the first quarter of fiscal year 2015.

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 1/2 calendar months before its results for the current period were compared with its results for the prior period. For example, the sales related to the warehouse club opened in Bogota, Colombia on October 29, 2014 were not used in the calculation of comparable sales until January 2016. Sales related to the warehouse clubs opened in

Pereira and Medellin, Colombia on November 13, 2014 and November 26, 2014,

40

Table of Contents

respectively, were not used in the calculation of comparable sales until January and February 2016, respectively. Sales related to the warehouse club opened in Panama (“Costa Verde”) in June 2015 and the warehouse club opened in Nicaragua opened in November 2015 will not be used in the calculation of comparable sales until September 2016 and January 2017, respectively.

As part of the expansion of our e-commerce program, we began direct home delivery of products not carried in our warehouse clubs to members in Colombia in August 2015. For e-commerce sales, revenue is recognized upon pickup of the merchandise by the member or when the common carrier takes possession of the merchandise. Currently these e-commerce sales of products not carried in our warehouse clubs and shipped directly to our members are being excluded from our comparable sales. Sales related to these e-commerce sales will not be used in the calculation of comparable sales until October 2016. E-commerce sales of products where the product is sourced from one of our warehouse clubs and delivered to the members home and sales of products that are not carried in our clubs, but are delivered to clubs and picked up by our members, are reflected in the comparable sales for the warehouse club from which the inventory was sourced or picked up.

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

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 ending May 29, 2016 decreased 2.8%, compared to the same 13-week period last year. Comparable warehouse sales were negatively impacted by the devaluation of the Colombian peso from the year ago period. Six warehouse clubs in Colombia are included in the calculation of comparable warehouse sales. Excluding those warehouse clubs, the 13-week comparable warehouse sales for the other 30 warehouse clubs open for at least 13 ½ months decreased 0.4%. We opened a new warehouse club west of Panama City, Panama in June 2015 and one in Managua, Nicaragua in November 2015. These new warehouse clubs are not far from existing warehouse clubs which are included in the calculation for comparable warehouse club sales. In both cases they are attracting new members from areas not previously served by us. However, it is also creating the opportunity for some existing members, particularly those who now find the new clubs closer to their homes, to shop at the new locations. This transfer of sales from an 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 has an adverse impact on comparable warehouse club sales.

Comparable warehouse sales for the 36 warehouse clubs that were open for at least 13 ½ months decreased 0.8% for the 39-week period ended May 29, 2016, compared to the same 39-week period last year. Excluding Colombia, the 39-week comparable warehouse sales increased 2.4%.

Export Sales

Three Months Ended

May 31, 2016

May 31, 2015

	Amount	% of net sales	Increase/ (decrease) from prior year	Change	Amount	% of net sales
Export sales	\$ 7,091	1.0 %	\$ (2,374)	(25.1)%	\$ 9,465	1.4 %

Nine Months Ended

May 31, 2016

May 31, 2015

	Amount	% of net sales	Increase/ (decrease) from prior year	Change	Amount	% of net sales
Export sales	\$ 21,872	1.0 %	\$ (2,254)	(9.3)%	\$ 24,126	1.2 %

Export sales are direct sales to a single institutional customer (retailer) in the Philippines for which we earn an approximately 5% margin. Changes in the activity in the three-month and nine-month periods ended May 31, 2016 compared to the prior year periods reflects changes in the merchandise needs of that retailer's business.

Table of Contents

Membership Income

	Three Months Ended			May 31, 2015
	May 31, 2016	Increase from prior year	% Change	
Membership income	Amount \$ 11,475	\$ 286	2.6 %	Amount \$ 11,189
Membership income % to net warehouse club sales	1.7 %			1.7 %
Number of total accounts	1,477,303	47,457	3.3 %	1,429,846

	Nine Months Ended			May 31, 2015
	May 31, 2016	Increase from prior year	% Change	
Membership income	Amount \$ 34,226	\$ 2,024	6.3 %	Amount \$ 32,202
Membership income % to net warehouse club sales	1.6 %			1.6 %
Number of total accounts	1,477,303	47,457	3.3 %	1,429,846

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

Membership income is recognized ratably over the one-year life of the membership. The 2.6% increase in membership income on a 3.3% increase in member accounts primarily reflects the impact of the Colombian peso on the translation of membership fees priced in Colombian pesos and translated to U.S. dollars. The membership income recognized in U.S. dollars in Colombia per member is 17.5% less in the current quarter compared to the second quarter of fiscal year 2015. Excluding Colombia, the average income recognized per member account in the current quarter is equal to that of a year ago.

During the first nine months of fiscal year 2016, the Company experienced an overall reduction of 8,979 membership accounts from August 31, 2015. Colombia's membership accounts during that period declined 65,251 due to the first

anniversary date for a large number of accounts associated with the three warehouse clubs in Colombia that opened in October and November of 2015 and the low renewal rate for those accounts. The opening of these three warehouse clubs in fiscal year 2015 resulted in approximately 124,000 expiring accounts in October, November and December from the record number of new member sign-ups experienced at the opening of these clubs. As expected, we experienced a low renewal rate for those expiring accounts through the period (although it is not uncommon for accounts to renew up to three months following their expiration date) due to a historically low renewal rate for first year members across our markets, the distance of our warehouse clubs in Bogota and Medellin to where certain members live, and the impact of price increases on imported products due to the Colombian peso devaluation. While we continue to see new member sign-ups in Colombia, the renewal rate of current members in Colombia is below that which we experience in other markets. As a result, the Company's twelve-month renewal rate for the period ended May 31, 2016 declined to 80% from 86% for the twelve months ended August 31, 2015. Excluding Colombia, the twelve-month renewal rate was 87% as of May 2016, consistent with 87% in August 2015, November 2015, and February 2016.

Other Income

	Three Months Ended			
	May 31, 2016	Increase from prior year	% Change	May 31, 2015
	Amount			Amount
Other income	\$ 1,149	\$ 14	1.2 %	\$ 1,135

Table of Contents

Nine Months Ended

	May 31, 2016	Increase from prior year	% Change	May 31, 2015
	Amount			Amount
Other income	\$ 3,661	\$ 417	12.9 %	\$ 3,244

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

For the three-month period, we recorded approximately \$224,000 in insurance gains, offset by decreases in rental income and other miscellaneous income.

For the nine-month period, the primary factor for the period-over-period increase was a \$202,000 gain recorded in the first quarter of fiscal year 2016 associated with an insurance recovery for the fire in the Pradera, Guatemala warehouse club in June 2015 and approximately \$224,000 in insurance gains recorded during the third quarter of fiscal year 2016.

Gross Margin

Warehouse Gross Profit Margin

Three Months Ended May 31, 2016			May 31, 2015	
Amount	Increase/ (decrease)	% to sales	Amount	% to sales
		from		

Edgar Filing: PRICESMART INC - Form 10-Q

		prior year			
Warehouse club sales	\$ 684,547	\$ 9,233	100.0 %	\$ 675,314	100.0 %
Less associated cost of goods	590,500	11,632	86.3 %	578,868	85.7 %
Warehouse gross profit margin	\$ 94,047	\$ (2,399)	13.7 %	\$ 96,446	14.3 %

	Nine Months Ended					
	May 31, 2016			May 31, 2015		
		Increase/				
		(decrease)				
		from				
	Amount	prior year	% to	Amount	% to	
Warehouse club sales	\$ 2,134,365	\$ 90,516	100.0 %	\$ 2,043,849	100.0 %	
Less associated cost of goods	1,832,183	88,411	85.8 %	1,743,772	85.3 %	
Warehouse gross profit margin	\$ 302,182	\$ 2,105	14.2 %	\$ 300,077	14.7 %	

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

For the three months ended May 31, 2016, warehouse gross profit margin as a percent of sales was 54 basis points (0.54%) lower than the three months ended May 31, 2015. Warehouse gross profit margin as a percent of sales decreased 154 basis points (1.54%) in Colombia from the year ago period largely as a result of pricing actions we continue to take to provide value on imported goods to our members. Warehouse gross profit margins as a percent of sales in the non-Colombia markets were in aggregate 57 basis points (0.57%) lower, resulting from a higher level of markdowns, reduced endcap activity and higher per unit distribution costs.

For the nine months ended May 31, 2016, warehouse gross profit margin as a percent of sales was 52 basis points (0.52%) lower than the nine months ended May 31, 2015. Warehouse gross profit margin as a percent of sales decreased 195 basis points (1.95%) in Colombia from the year ago period largely as a result of pricing actions we continue to take to provide value on imported goods to our members. Warehouse gross profit margins as a percent of sales in the non-Colombia markets were in aggregate 50 basis points (0.50%) lower resulting from a higher level of markdowns, reduced endcap activity and higher per unit distribution costs.

Table of Contents

Export Sales Gross Profit Margin

	Three Months Ended May 31, 2016			May 31, 2015		
	Amount	Increase/ (decrease) from prior year	% to sales	Amount	% to sales	
Export sales	\$ 7,091	\$ (2,374)	100.0 %	\$ 9,465	100.0 %	
Less associated cost of goods sold	6,742	(2,250)	95.1 %	8,992	95.0 %	
Export sales gross profit margin	\$ 349	\$ (124)	4.9 %	\$ 473	5.0 %	

	Nine Months Ended May 31, 2016			May 31, 2015		
	Amount	Increase/ (decrease) from prior year	% to sales	Amount	% to sales	
Export sales	\$ 21,872	\$ (2,254)	100.0 %	\$ 24,126	100.0 %	
Less associated cost of goods sold	20,799	(2,154)	95.1 %	22,953	95.1 %	
Export sales gross profit margin	\$ 1,073	\$ (100)	4.9 %	\$ 1,173	4.9 %	

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

The decrease in export sales gross margin dollars for the three and nine months ended May 31, 2016 compared to the same period a year ago was due to decrease in direct sales to an institutional customer (retailer) in the Philippines for which we generally earn lower margins than those obtained through our warehouse club sales.

Selling, General and Administrative Expenses

Warehouse Club Operations

	Three Months Ended May 31, 2016				May 31, 2015		
	Amount	% to warehouse club sales	Increase from prior year	% Change	Amount	% to warehouse club sales	
Warehouse club operations expense	\$ 62,745	9.2 %	\$ 1,991	3.3 %	\$ 60,754	9.0 %	

	Nine Months Ended May 31, 2016				May 31, 2015		
	Amount	% to warehouse club sales	Increase from prior year	% Change	Amount	% to warehouse club sales	
Warehouse club operations expense	\$ 188,348	8.8 %	\$ 9,342	5.2 %	\$ 179,006	8.8 %	

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

As a percent of net warehouse sales, warehouse club operations expense for the third quarter of fiscal year 2016 increased 17 basis points (0.17%) to 9.2%. Warehouse club operations expense in the third quarter of fiscal year 2015 included \$2.5 million of costs associated with two additional warehouse clubs (Panama and Nicaragua) compared to the same period last year. This was offset by warehouse club operations expense in Colombia which decreased \$1.6 million due to the translation effect of expenses incurred in pesos when converted to U.S. dollars.

For the nine-month period, the additional expenses associated with five additional warehouse clubs for all or a portion of the period compared to the same nine-month period a year ago resulted in warehouse operating expense as a percent of net warehouse sales increasing six basis points (0.06%).

Table of Contents

General and Administrative Expenses

	Three Months Ended					
	May 31, 2016			May 31, 2015		
	Amount	% to warehouse club sales	Increase from prior year	% Change	Amount	% to warehouse club sales
General and administrative expenses	\$ 16,439	2.4 %	\$ 2,225	15.7 %	\$ 14,214	2.1 %

	Nine Months Ended					
	May 31, 2016			May 31, 2015		
	Amount	% to warehouse club sales	Increase from prior year	% Change	Amount	% to warehouse club sales
General and administrative expenses	\$ 48,086	2.3 %	\$ 6,405	15.4 %	\$ 41,681	2.0 %

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

For the three and nine month periods, general and administrative expenses grew 15.7% and 15.4%, respectively, resulting from additional staffing to support the Company's growth, most notably in the buying and information technology areas, and increased deferred compensation expense associated with stock awards granted in the first quarter, totaling approximately \$871,000 in the current quarter and \$2.1 million for the nine-month period.

Pre-Opening Expenses

Expenses incurred before a warehouse club is in operation are captured in pre-opening expenses.

	Three Months Ended			May 31,
	May 31,			May 31,
	2016			2015
	Increase/ (decrease) from prior			
	Amount	year	% Change	Amount
Pre-opening expenses	\$ 13	\$ (20)	(60.6) %	\$ 33

	Nine Months Ended			May 31,
	May 31,			May 31,
	2016			2015
	Increase/ (decrease) from prior			
	Amount	year	% Change	Amount
Pre-opening expenses	\$ 389	\$ (3,022)	(88.6) %	\$ 3,411

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

Pre-opening expenses incurred in the current period were for the Company's planned new warehouse club opening in Chia, Colombia. During the nine months ended May 31, 2016 pre-opening expenses were related to the warehouse club opened in Managua, Nicaragua during November 2015. The pre-opening expenses for the three and nine months ended on May 31, 2015 were for the three Colombia warehouse clubs (Bogota, Pereira and Medellin) which opened in October and November of 2014, and the Panama warehouse club which opened in June 2015.

Table of Contents

Loss/(Gain) on Disposal of Assets

Asset disposal activity consisted mainly of normally scheduled asset replacement and upgrades.

	Three Months Ended May 31, 2016			May 31, 2015
	Increase/ (decrease) from prior Amount		% Change	Amount
Loss/(gain) on disposal of assets	\$ 334	\$ (390)	(53.9) %	\$ 724

	Nine Months Ended May 31, 2016			May 31, 2015
	Increase/ (decrease) from prior Amount		% Change	Amount
Loss/(gain) on disposal of assets	\$ 399	\$ (688)	(63.3) %	\$ 1,087

Operating Income

Three Months Ended

May 31, 2016

May 31, 2015

Edgar Filing: PRICESMART INC - Form 10-Q

	Amount	% to warehouse club sales	Increase/ (decrease) from prior year	% Change	Amount	% to warehouse club sales
Operating income	\$ 27,489	4.0 %	\$ (6,029)	(18.0)%	\$ 33,518	5.0 %

	Nine Months Ended May 31, 2016				May 31, 2015			
	Amount	% to warehouse club sales	Increase/ (decrease) from prior year	% Change	Amount	% to warehouse club sales		
Operating income	\$ 103,920	4.9 %	\$ (7,591)	(6.8)%	\$ 111,511	5.5 %		

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

For the three months ended May 31, 2016, operating income declined \$6.0 million compared to the prior year. A 21% decrease in net warehouse sales and increased operational expenses resulted in a \$1.5 million higher operating loss in Colombia. Lower warehouse margin as a percent of sales and increased operational expenses in the non-Colombia segments accounted for \$4.5 million in reduced operating income.

For the nine months ended May 31, 2016, operating income decreased \$7.6 million compared to the prior year period primarily resulting from decreases in warehouse margins and increased operational expenses.

Table of Contents

Interest Expense

	Three Months Ended		
	May 31, 2016		May 31, 2015
	Amount	Increase/ (decrease) from prior year	Amount
Interest expense on loans	\$ 1,256	\$ 330	\$ 926
Interest expense related to hedging activity	461	(376)	837
Capitalized interest	(146)	2	(148)
Net interest expense	\$ 1,571	\$ (44)	\$ 1,615

	Nine Months Ended		
	May 31, 2016		May 31, 2015
	Amount	Increase/ (decrease) from prior year	Amount
Interest expense on loans	\$ 3,582	\$ (25)	\$ 3,607
Interest expense related to hedging activity	1,478	(585)	2,063
Capitalized interest	(580)	331	(911)
Net interest expense	\$ 4,480	\$ (279)	\$ 4,759

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

Interest expense reflects borrowings by our wholly owned foreign subsidiaries to finance new warehouse club construction and land acquisition, the capital requirements of warehouse club operations and ongoing working capital requirements.

Edgar Filing: PRICESMART INC - Form 10-Q

Net interest expense for the three months ended May 31, 2016 decreased from a year ago, with an increase in interest expense on loans and a small increase in the net interest expense due to a small decrease in interest capitalized. These increases are largely offset by a decrease on interest expenses related to hedging activity. Increases in interest expense on loans is mainly the result of interest paid on short-term loans and special fund interest charges charged on interest payments in various of the countries in which we do business. The decrease in interest expense related to hedging activity is a result of the retirement of loans and their related cross-currency interest rate hedges for our Colombia subsidiary.

Net interest expense for the nine months ended May 31, 2016 decreased from a year ago due to a decrease in interest expense from hedging activity. This was primarily related to the retirement of loans and their related cross-currency interest for our Colombia subsidiary. This decrease was partially offset by an increase in interest expense related to the decrease in capitalized interest as a result of the decrease in warehouse club construction.

Other Income (Expense), net

Other income consists of currency gain or loss.

	Three Months Ended			May 31,
	May 31,			2015
	2016	Decrease from		
	Amount	prior year	%Change	Amount
Other income (expense), net	\$ (222)	\$ 89	(28.6) %	\$ (311)

Table of Contents

	Nine Months Ended May 31, 2016			May 31, 2015
	Decrease from			
	Amount	prior year	%Change	Amount
Other income (expense), net	\$ (1,018)	\$ 3,584	(77.9) %	\$ (4,602)

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 gain (losses), including repatriation of funds, are recorded as currency gain or losses.

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

For the three-month period, the slight improvement from the prior year is mostly related to Colombia where we have taken a number of actions to mitigate any large exposures to the Colombian peso, including increased capitalization of the Colombian subsidiary, which allows for timely payments for merchandise and fixed assets shipped to Colombia. Additionally, we have experienced increased volatility of currencies within our other markets that have largely offset each other.

For the nine-month period, the improvement from the prior year is mostly related to Colombia where we have taken a number of actions to mitigate any large exposures to the Colombian peso, including increased capitalization of the Colombian subsidiary, which allows for timely payments for merchandise and fixed assets shipped to Colombia.

Provision for Income Taxes

Edgar Filing: PRICESMART INC - Form 10-Q

	Three Months Ended		
	May 31, 2016		May 31, 2015
		Increase/ (decrease)	
		from	
	Amount	prior year	Amount
Current tax expense	\$ 10,405	\$ 564	\$ 9,841
Net deferred tax provision (benefit)	(1,237)	(2,146)	909
Provision for income taxes	\$ 9,168	\$ (1,582)	\$ 10,750
Effective tax rate	35.2 %		33.7 %

	Nine Months Ended		
	May 31, 2016		May 31, 2015
		Increase/ (decrease)	
		from	
	Amount	prior year	Amount
Current tax expense	\$ 34,335	\$ 1,345	\$ 32,990
Net deferred tax provision (benefit)	(1,222)	(4,610)	3,388
Provision for income taxes	\$ 33,113	\$ (3,265)	\$ 36,378
Effective tax rate	33.4 %		35.3 %

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

The variance in the effective tax rate for the three months ended May 31, 2016 compared to the same period of the prior year was primarily attributable to the unfavorable impact of 1.9% resulting from an increased taxable loss incurred in the Company's Colombia subsidiary for which no tax benefit was recognized, net of adjustment to valuation allowance, and the favorable impact of 0.7% due to the relative decrease in U.S. taxable income, which is taxed at a higher statutory tax rate compared to tax rates in foreign jurisdictions.

Table of Contents

The variance in the effective tax rate for the nine months ended May 31, 2016 compared to the prior year was primarily attributable to the favorable impact of 1.0% resulting from a decreased taxable loss incurred in the Company's Colombia subsidiary for which no tax benefit was recognized, net of adjustment to valuation allowance, and the favorable impact of 0.6% due to the relative decrease in U.S. taxable income, which is taxed at a higher statutory tax rate compared to tax rates in foreign jurisdictions.

Other Comprehensive Income (Loss)

	Three Months Ended May 31, 2016			May 31, 2015
	Amount	Increase/ (decrease) from prior year	% Change	Amount
Other comprehensive income (loss)	\$ 6,312	\$ 7,969	(480.9) %	\$ (1,657)

	Nine Months Ended May 31, 2016			May 31, 2015
	Amount	Increase/ (decrease) from prior year	% Change	Amount
Other comprehensive income (loss)	\$ (4,919)	\$ 15,851	(76.3) %	\$ (20,770)

Comparison of Three and Nine Months Ended May 31, 2016 and 2015

Other comprehensive income for the third quarter of fiscal year 2016 resulted primarily from comprehensive income of approximately \$6.5 million for the foreign currency translation adjustments related to assets and liabilities and the translation of the statement of income related to revenue, costs and expenses of our subsidiaries whose functional currency is not the U.S. dollar offset by comprehensive losses of approximately \$191,000 related to unrealized losses on change in derivative obligations. When the functional currency in our international subsidiaries is the local currency and not U.S. dollars, the assets and liabilities of such 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 not affect net income until the sale or liquidation of the underlying investment. The reported other comprehensive income or loss reflects the unrealized increase or decrease in the value in U.S. dollars of the net assets of the subsidiaries as of the date of the balance sheet, which will vary from period to period as exchange rates fluctuate. During the three months ended May 31, 2016, the largest translation adjustments were related to the translation of the Colombia subsidiary's balance sheet and statement of operations. Other comprehensive loss for the third quarter of fiscal year 2015 resulted primarily from comprehensive losses of approximately \$1.7 million for the foreign currency translation adjustments related to assets and liabilities and the translation of the statement of income related to revenue, costs and expenses of our subsidiaries whose functional currency is not the U.S. dollar offset by approximately \$38,000 related to unrealized gains on changes in derivative obligations. When compared to the nine months ended May 31, 2016, the strengthening of the Colombian Peso in the third quarter resulted in the Company recording comprehensive income; whereas, during the first six months of fiscal year 2016, the devaluation of the Colombian Peso resulted in the Company recording comprehensive losses. During the three months ended May 31, 2015, the largest translation adjustments were related to the translation of the Colombia subsidiary's balance sheet and statement of income.

Other comprehensive loss for first nine months of fiscal year 2016 resulted primarily from other comprehensive losses for approximately \$522,000 related to unrealized losses on changes in derivative obligations and approximately \$4.4 million for the foreign currency translation adjustments related to the assets and liabilities and the translation of the statement of income related to revenue, costs and expenses of our subsidiaries whose functional currency is not the U.S. dollar. During the nine months ended May 31, 2016, the largest translation adjustments were related to the translation of the Colombia subsidiary's balance sheet and statement of operations. Other comprehensive loss for first nine months of fiscal year 2015 resulted primarily from other comprehensive losses of approximately \$24.2 million for the foreign currency translation adjustments related to the assets and liabilities and the translation of the statement of income related to revenue, costs and expenses of our subsidiaries whose functional currency is not the U.S. dollar offset by comprehensive income of approximately \$3.5 million related to gains on

Table of Contents

changes in derivative obligations. During the nine months ended May 31, 2015, the largest translation adjustments were related to the translation of the Colombia subsidiary's balance sheet and statement of income.

LIQUIDITY AND CAPITAL RESOURCES

Financial Position and Cash Flow

We require cash to fund our operating expenses and working capital requirements, including the investment in merchandise inventories, acquisition of land and construction of new warehouse clubs, expansion of existing warehouse clubs and distribution centers, acquisitions of fixtures and equipment, routine upgrades and maintenance of fixtures and equipment within existing warehouse clubs, investments in joint ventures in Panama and Costa Rica to own and operate commercial retail centers located adjacent to the new warehouse clubs, the purchase of treasury stock upon the vesting of restricted stock awards and payment of dividends to stockholders. Our primary sources for funding these requirements are cash and cash equivalents on hand, cash generated from operations and bank borrowings. We evaluate on a regular basis whether we may need to borrow additional funds to cover any shortfall in our ability to generate sufficient cash from operations to meet our operating and capital requirements. As such, we may enter into or obtain additional loans and/or credit facilities to provide additional liquidity when necessary.

The following table summarizes the cash and cash equivalents held by our foreign subsidiaries and domestically (in thousands). Repatriation of cash and cash equivalents held by foreign subsidiaries may require us to accrue and pay taxes. We have no plans at this time to repatriate cash through the payment of cash dividends by our foreign subsidiaries to our domestic operations and, therefore, have not accrued taxes that would be due from repatriation.

	May 31, 2016	August 31, 2015
Cash and cash equivalents held by foreign subsidiaries	\$ 165,704	\$ 124,952
Cash and cash equivalents held domestically	36,912	32,120
Total cash and cash equivalents	\$ 202,616	\$ 157,072

Our cash flows are summarized as follows (in thousands):

	Nine Months Ended	
	May 31, 2016	May 31, 2015
Net cash provided by (used in) operating activities	\$ 112,168	\$ 65,738
Net cash provided by (used in) investing activities	(51,927)	(63,431)
Net cash provided by (used in) financing activities	(11,193)	6,819
Effect of exchange rates	(3,504)	(631)
Net increase (decrease) in cash and cash equivalents	\$ 45,544	\$ 8,495

Table of Contents

Our net cash provided by (used in) operating activities for the nine months ended May 31, 2016 and 2015 is summarized below:

	Nine Months Ended		Increase/ (Decrease)
	May 31,	May 31,	2016 to 2015
	2016	2015	
Net income	\$ 66,451	\$ 66,677	\$ (226)
Adjustments to reconcile net income to net cash provided from (used in) operating activities:			
Depreciation and amortization	29,003	25,173	3,830
(Gain) loss on sale of property and equipment	399	1,087	(688)
Deferred income taxes	(1,222)	3,388	(4,610)
Stock-based compensation expenses	6,152	3,402	2,750
Other non-cash operating activities	(362)	(90)	(272)
Net non-cash related expenses	33,970	32,960	1,010
Net income from operating activities reconciled for non-cash operating activities	100,421	99,637	784
Changes in operating assets and liabilities not including merchandise inventories and accounts payable	(2,281)	(9,101)	6,820
Changes in merchandise inventories	13,397	(39,801)	53,198
Changes in accounts payable	631	15,003	(14,372)
Net cash provided by (used in) operating activities	\$ 112,168	\$ 65,738	\$ 46,430

Net income from operating activities reconciled for non-cash operating activities increased \$1.0 million for the nine months ended May 31, 2016 over the same period last year. This was primarily a result of a year-on-year increase in non-cash adjustments of approximately \$1.0 million. The increase in non-cash adjustments was primarily driven by increases in depreciation expense for approximately \$3.8 million due to new warehouse club investment and the continued ongoing capital improvements to existing warehouse clubs and an increase in stock-based compensation expenses for approximately \$2.8 million offset by decreases period-over-period in the changes to deferred income taxes for approximately \$4.6 million. The decreased investment in merchandise inventories net of vendor accounts payable of \$38.8 million during the fiscal year reflects the overall period-on-period reduction in inventory builds due to fewer warehouse club openings during fiscal year 2016 compared to fiscal year 2015.

Our use of cash in investing activities for the nine months ended May 31, 2016 and 2015 is summarized below:

	Nine Months Ended		Increase/ (Decrease)
	May 31,	May 31,	2016 to
	2016	2015	2015
Cash used for additions of property and equipment:			
Land acquisitions	\$ 3,151	\$ 9,543	\$ (6,392)
Deposits for land purchase option agreements	442	(903)	1,345
Warehouse club expansion, construction, and land improvements	34,226	32,838	1,388
Acquisition of fixtures and equipment	14,085	20,660	(6,575)
Proceeds from disposals of property and equipment	(96)	(67)	(29)
Capital contribution to joint ventures	119	1,360	(1,241)
Net cash flows used by (provided in) investing activities	\$ 51,927	\$ 63,431	\$ (11,504)

Net cash used in investing activities decreased in the first nine months of fiscal year 2016 compared to fiscal year 2015 by approximately \$11.5 million primarily due to a decrease in cash expended for the purchase of land and the decrease in expenditures for the acquisition of fixtures and equipment. These decreases were partially offset by period-over-period increases in the expenditures for deposits made on land purchase options and warehouse club expansion activities. During the first nine months of fiscal year 2016, expenditures for warehouse club expansions and for fixtures and equipment were associated with the construction of the completed warehouse club in Managua, Nicaragua that opened in November 2015 and the start of construction activities of a warehouse club in Chia, Colombia, which increased during the third quarter of fiscal year 2016. Additionally, we made normal ongoing capital expenditures for replacement of equipment and building and leasehold improvements. Net cash used in investing activities in the first nine months of fiscal year 2015 consisted of cash expended for the construction and completion of warehouse clubs in Bogota, Colombia ("Salitre"), Pereira, Colombia, and Medellin, Colombia and the additions of fixtures and equipment for these warehouse clubs. Additionally, we began construction of a warehouse club in Panama during the first nine months of fiscal year 2015.

Table of Contents

We have either commitments or plans for capital spending during fiscal year 2016 for warehouse club construction of approximately \$5.2 million relating to a previously announced new warehouse club, and we expect to spend approximately \$19.9 million in other capital expenditures for ongoing replacement of equipment and building/leasehold improvements during the final three months of fiscal year 2016. Future capital expenditures will be dependent on the timing of future land purchases and/or warehouse club construction activity.

We have entered into land purchase option agreements within our subsidiaries that have not been recorded as a commitments, for which we have recorded within the balance sheet deposits of approximately \$642,000. These land purchase option agreements can be canceled at the sole option of the Company, with the Company forfeiting the deposits. We do not have a time table of when or if we will exercise these land purchase options, due to the uncertainty related to the completion of our due diligence review. Our due diligence review includes evaluations of the legal status of the property, the zoning and permitting issues related to acquiring approval for the construction and operation of a warehouse club and any other issues related to the property itself that could render the property unsuitable or limit the property's economic viability as a warehouse club site. If these purchase option agreements are exercised, the cash use would be approximately \$16.9 million.

In March 2016, the Company entered into a contract, subject to customary contingencies, to acquire a build-to-suit distribution center in Miami-Dade County, Florida, to which it will transfer the majority of its current Miami distribution center activities once the construction of the building is complete and the building is ready for occupancy. The Company currently expects completion to be in first half of calendar year 2017. The total purchase price is approximately \$46.0 million. The Company deposited into escrow \$300,000 of cash and approximately \$8.8 million through an irrevocable and unconditional standby letter of credit payable to the seller. This letter of credit also contains an automatic one year renewal and entitles the seller to draw upon this letter of credit fully or partially on demand to the Company if the seller, per the underlying build-to-suit purchase contract, is entitled to draw down upon the letter of credit under prescribed conditions.

Net cash (used in) provided by financing activities for the nine months ended May 31, 2016 and 2015 is summarized below:

Nine Months Ended		Increase/ (Decrease) 2016 to 2015
May 31,	May 31,	
2016	2015	

Edgar Filing: PRICESMART INC - Form 10-Q

New bank loans offset by establishment of certificates of deposit held against loans and payments on existing bank loans (loan activities)	\$ 794	\$ 20,614	\$ (19,820)
Cash dividend payments	(10,629)	(10,564)	(65)
Proceeds from exercise of stock options and the tax benefit related to stock options	579	1,269	(690)
Purchase of treasury stock related to vesting of restricted stock	(1,937)	(4,500)	2,563
Net cash (used) in/provided by financing activities	\$ (11,193)	\$ 6,819	\$ (18,012)

Net cash provided by loan activities decreased approximately \$19.8 million over the same period in fiscal year 2015. We received cash during the first nine months of fiscal year 2016 from short-term borrowings for approximately \$18.8 million and cash from additional long-term loans entered into by our Costa Rica subsidiary of approximately \$7.4 million. This increase in cash was offset by regularly scheduled loan payments of \$10.2 million on the long-term loans and payments for approximately \$15.2 million on the short-term loans. During the nine months ended May 31, 2015, we received cash from six additional loans entered into by our Panama, Honduras (three loans in Honduras), Trinidad and Colombia subsidiaries for approximately \$10.0 million, \$16.9 million, \$3.6 million and \$15.0 million, respectively. Additionally, \$2.9 million in restricted cash was released back to us due to the repayment of one of the loans borrowed by our Honduras subsidiary. These increases were offset by repayments of long-term loans of approximately \$3.3 million and \$13.2 million by our Honduras subsidiary and \$3.2 million by our Trinidad subsidiary and regularly scheduled loan payments of \$8.1 million.

The following table summarizes the dividends declared and paid during fiscal year 2016 and 2015.

Declared	Amount	First Payment			Amount	Second Payment			
		Record Date	Date Paid	Date Payable		Record Date	Date Paid	Date Payable	Amount
2/3/2016	\$ 0.70	2/15/2016	2/29/2016	N/A	\$ 0.35	8/15/2016	N/A	8/31/2016	\$ 0.35
2/4/2015	\$ 0.70	2/13/2015	2/27/2015	N/A	\$ 0.35	8/14/2015	8/31/2015	N/A	\$ 0.35

We anticipate 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

Table of Contents

determination by the Board of Directors at its discretion after its review of the Company's financial performance and anticipated capital requirements.

Financing Activities

On September 18, 2015, the Company's Costa Rica subsidiary entered into a loan agreement with Banco BAC San Jose S.A. The agreement establishes a credit facility for 3.955 billion Costa Rican Colones ("CRC") (approximately US \$7.4 million) with a fixed interest rate of 7.5% for the first two years, and a rate of 3.0% over the rate of interest used by individual commercial banks as a basis for their lending rates as published by the Central Bank of Costa Rica for the remainder of the term. The loan term is for seven years with a twelve-month grace period on principal repayment. Monthly interest is due beginning with the first month and monthly principal payments are due after the twelve-month grace period ends. The loan was funded on September 30, 2015.

On August 28, 2015, the Company's Costa Rica subsidiary entered into a loan agreement with Citibank, N.A. ("Citi"). The agreement provides for a US \$7.5 million loan to be repaid in 20 quarterly principal payments of US \$187,500 plus interest, and balloon payment of US \$3,750,000 due on August 28, 2020. The interest rate is set at the three-month LIBOR rate plus 2.50%. The loan is secured by a guarantee from PriceSmart, Inc. The US \$7.5 million loan was funded on August 28, 2015. The Company entered into a cross-currency interest rate debt service swap agreement on August 31, 2015 with Citi. The Company will receive variable U.S. dollar interest based on the three-month LIBOR rate plus 2.50% on an amortizing notional of US \$7.5 million and pay fixed CRC interest of 7.65% on an amortizing notional of CRC 4,035,000,000 for a term of approximately five years. The swap agreement stipulates quarterly net settlement of notional amounts whereby the Company receives US \$187,500 from Citi and in exchange the Company pays CRC 100,875,000. The Company has economically hedged the currency exposure of the balloon payment using a non-deliverable forward contract. However, this economic hedge will not be designated as such for accounting purposes; therefore, the change in fair value of the non-deliverable forward will be accounted for in earnings.

In August 2015, the Company's Colombia subsidiary paid off the outstanding loan principal balance of US \$8.0 million under a loan agreement entered into with Scotiabank & Trust (Cayman) Ltd. The Company's subsidiary also settled the cross-currency interest rate swaps that it had entered into with the Bank of Nova Scotia related to this loan. Our Colombia subsidiary and Scotiabank & Trust (Cayman) Ltd. had entered into a loan agreement in March 2011 which was amended and restated in January 2012. The amendment increased the credit facility by US \$16.0 million; as a result the total credit facility with Scotiabank & Trust (Cayman) Ltd. was for US \$32.0 million. The interest rate on the incremental amount of the facility as the tranches were drawn was three-month LIBOR rate plus 0.6%. The loan term continued to be five years with interest only payments and a balloon payment at maturity. The deposits earned interest at a rate equal to three-month LIBOR. The first tranche of US \$8.0 million from the incremental US \$16.0 million of the credit facility was funded in February 2012, and we secured this portion of the loan with a US \$8.0 million secured time deposit pledged by our Costa Rica subsidiary. The Company's Colombia subsidiary concurrently entered into a cross-currency interest rate swap agreements with Scotiabank for the

notional amount of a US \$8.0 million. The cross-currency interest rate swap agreements converted the Colombia subsidiary's U.S. dollar denominated principal and floating interest payments on the US \$8.0 million long-term quarterly amortizing debt with Scotiabank & Trust (Cayman) Ltd. to functional currency principal and fixed interest payments during the life of the hedging instruments. As changes in foreign exchange and interest rates impacted cash flows of principal and interest payments, the hedges were intended to offset changes in cash flows attributable to interest rate and foreign exchange movements. The hedged loan had a variable interest rate of three-month LIBOR plus 0.6%. Under the cross-currency interest rate swap agreements, the Company received variable U.S. dollar principal and interest based on the three-month LIBOR rate plus 0.6% on the quarterly amortizing notional amount of US \$8.0 million and paid fixed interest of 6.02% on the quarterly amortizing notional amount of 14.3 billion Colombia Pesos for a term of approximately five years. The LIBOR reset dates for these hedged long-term debt and the cross-currency interest rate swaps occurred quarterly.

In July 2015, the Company's Colombia subsidiary paid off outstanding loan principal balances of US \$16.0 million under loan agreements entered into with Scotiabank & Trust (Cayman) Ltd. The Company's subsidiary also settled the cross-currency interest rate swaps that it had entered into with the Bank of Nova Scotia related to these loans. The Colombia subsidiary had entered into the loan agreements with Scotiabank & Trust (Cayman) Ltd. in March 2011. These agreements established a credit facility for US \$16.0 million to be disbursed in three tranches. The interest rate was set at the three-month LIBOR rate plus 0.7%. The loan term was for five years with interest only payments and a balloon payment at maturity. These loans were secured by a time deposits of US \$16.0 million pledged by our Costa Rican subsidiary. The deposits earned interest at a rate equal to three-month LIBOR. The Company's Colombia subsidiary entered into three cross-currency interest rate swap agreements with Bank of Nova Scotia for the notional amount of US \$16.0 million. These cross-currency interest rate swaps agreements converted the Colombia subsidiary's U.S. dollar denominated principal and floating interest payments on the US \$16.0 million long-term quarterly amortizing debt with Scotiabank & Trust (Cayman) Ltd. to functional currency principal and fixed interest payments during the life of the hedging instruments. As changes in foreign exchange and interest rates impacted cash flows of principal and interest payments, the hedges were intended to offset changes in cash flows attributable to interest rate and foreign exchange movements. The hedged loans had a variable interest rate of three-month LIBOR plus 0.7%. Under the cross-currency interest rate swap agreements, the Company received variable U.S. dollar principal and interest based on the three-month LIBOR rate

Table of Contents

plus 0.7% on the quarterly amortizing notional amount of US \$16.0 million and paid fixed interest of 6.09%, 5.3% and 5.45% on the quarterly amortizing notional amounts of \$14.1 billion, \$3.8 billion, and \$11.4 billion Colombia Pesos for a term of approximately five years. The LIBOR reset dates for these hedged long-term debt and the cross-currency interest rate swaps occurred quarterly.

In March 2015, the Company's Honduras subsidiary paid off the outstanding principal balance of 179.3 million Lempiras (approximately US \$8.2 million) under the loan agreement entered into by the subsidiary in March 2014 with Banco de America Central Honduras, S.A. The original agreement established a loan facility of 286.0 million Lempiras (approximately US \$13.7 million). The interest rate was variable, with a minimum of 12.5% (12.75% at the time of pay-off). The loan term was for ten years with quarterly interest and principal payments, subject to a 24-month grace period on principal payments.

In March 2015, the Company's Honduras subsidiary entered into a loan agreement with Citibank, N.A. The agreement establishes a credit facility for US \$8.5 million with a variable interest rate of three-month LIBOR plus 3.25%. The loan term is for five years with quarterly interest and principal payments. This loan is secured by assets of the Company's Honduras subsidiary. The loan was funded at execution. In March 2015, the Company's Honduras subsidiary entered into a cross-currency interest rate swap agreement with Citibank, N.A. for a notional amount of US \$8.5 million. The cross-currency interest rate swap agreement converts the Honduras subsidiary's U.S. dollar denominated principal and floating interest payments on the US \$8.5 million long-term quarterly amortizing debt with Citibank to functional currency principal and fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of principal and interest payments, the hedge is intended to offset changes in cash flows attributable to interest rate and foreign exchange movements. The hedged loan has a variable interest rate of three-month LIBOR plus 3.25%. Under the cross-currency interest rate swap agreement, the Company will receive variable U.S. dollar principal and interest based on the three-month LIBOR rate plus 3.25% on a quarterly amortizing notional amount of US \$8.5 million and pay fixed interest of 10.75% on a quarterly amortizing notional amount of 185.6 million Honduran Lempiras for a term of approximately five years (effective date of March 24, 2015 through March 20, 2020). The LIBOR reset dates for the hedged long-term debt and the cross-currency interest rate swap occur on the 24th day of March, June, September, and December beginning on June 24, 2015.

In February 2015, the Company's Honduras subsidiary paid down a loan entered into in March 2010. The loan agreement was with Banco Del Pais, S.A. for a loan based in Honduran Lempiras that was equivalent to approximately US \$6.0 million, which was scheduled to be paid over five years. The Company's Honduras subsidiary also had an agreement with Banco Del Pais to open and maintain a certificate of deposit as collateral for this loan. The certificate of deposit was automatically renewable by Banco Del Pais on an annual basis for the net amortized outstanding balance. The net amortized outstanding balance for the loan on the date of the loan pay down was approximately US \$87,000. The certificate of deposit released at the date of payment was approximately US\$2.9 million.

In January 2015, the Company's Trinidad subsidiary entered into a loan agreement with Citibank, Limited. The agreement establishes a credit facility for \$23.0 million Trinidad and Tobago Dollars (approximately \$3.6 million U.S. dollars) with a fixed interest rate of 4.45%. The loan term is for four years with monthly interest and quarterly principal payments. The loan was funded in February 2015.

In December 2014, the Company's Colombia subsidiary entered into a loan agreement with Citibank, N.A. The agreement establishes a credit facility for US \$15.0 million with a variable interest rate of three-month LIBOR plus 2.8%. The loan term is for five years with quarterly interest and principal payments. The loan was funded in December 2014. Also in December 2014, the Company's Colombia subsidiary entered into a cross-currency interest rate swap agreement with Citibank, N.A for a notional amount of US \$15.0 million related to this loan. The cross-currency interest rate swap agreement converts the Colombia subsidiary's U.S. dollar denominated principal and floating interest payments on the first US \$7.9 million of the total US \$15.0 million long-term quarterly amortizing debt with Citibank to functional currency principal and fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of principal and interest payments, the hedge is intended to offset changes in cash flows attributable to interest rate and foreign exchange movements. Under the cross-currency interest rate swap agreement, the Company will receive variable U.S. dollar principal and interest based on the three-month LIBOR rate plus 2.8% on a quarterly amortizing notional amount of US \$15.0 million and pay fixed interest of 8.25% on a quarterly amortizing notional amount of 34,350,000,000 Colombian Pesos for a term of approximately five years. The LIBOR reset dates for the hedged long-term debt and the cross-currency interest rate swap occur on the fourth day of March, June, September, and December beginning in March 2015.

In November 2014, our Panama subsidiary drew down the final US \$10.0 million available against the credit facility established in March 2014 under a loan agreement with The Bank of Nova Scotia. That agreement established a credit facility of US \$34.0 million at a variable interest rate of 30-day LIBOR plus 3.5% for a five year term, monthly principal and interest payments, and a US \$17.0 million principal payment due at maturity. The facility provides a five year renewal option upon approval of the Bank of Nova Scotia. The loan is secured by assets of our Panama subsidiary. During April 2014, we drew down US \$24.0 million of the US \$34.0 million facility and repaid borrowings due to MetroBank, S.A. of US \$3.2 million. In December 2014, the Company's Panama subsidiary entered into an interest rate swap agreement with the Bank of Nova Scotia

Table of Contents

for a notional amount of US \$10.0 million related to this loan. The interest rate swap agreement converts the Panama subsidiary's floating interest payments on the first US \$5.0 million of the total US \$10.0 million long-term monthly amortizing debt with the Bank of Nova Scotia to fixed interest payments during the life of the hedging instrument. As changes in interest rates impact the future cash flows of loan interest payments, the hedge is intended to offset changes in cash flows attributable to variable interest rate movements. Under the interest rate swap agreement, the Company will receive variable interest based on the 30-day LIBOR rate plus 3.5% on a monthly amortizing notional amount of US \$10.0 million and pay fixed interest of 5.2% for a term of approximately five years. The LIBOR reset dates for the hedged long-term debt and the interest rate swap occur on the 28th day of each month beginning on December 29, 2014.

In October 2014, our Honduras subsidiary entered into a loan agreement with Citibank, N.A. The agreement establishes a credit facility for US \$5.0 million with a variable interest rate of three-month LIBOR plus 3.5%. The loan term is for five years with quarterly interest and principal payments. This loan is secured by assets of the Company's Honduras subsidiary. In October 2014, the Company's Honduras subsidiary entered into a cross-currency interest rate swap agreement with Citibank, N.A for a notional amount of US \$5.0 million. The cross-currency interest rate swap agreement converts the Honduras subsidiary U.S. dollar denominated principal and floating interest payments on the first US \$3.0 million of the total US \$5.0 million long-term quarterly amortizing debt with Citibank to functional currency principal and fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of principal and interest payments, the hedge is intended to offset changes in cash flows attributable to interest rate and foreign exchange movements. Under the cross-currency interest rate swap agreement, the Company will receive variable U.S. dollar principal and interest based on the three-month LIBOR rate plus 3.5% on a quarterly amortizing notional amount of US \$5.0 million and pay fixed interest of 11.6% on a quarterly amortizing notional amount of 106,576,000 Honduran Lempiras for a term of approximately three years. The LIBOR reset dates for the hedged long-term debt and the cross-currency interest rate swap occur on the 22nd day of January, April, July, and October, beginning on January 22, 2015. The loan was funded at execution.

In October 2014, our Honduras subsidiary paid off the US \$3.2 million outstanding under the loan agreement entered into by the subsidiary on January 12, 2010 with Scotiabank El Salvador, S.A. The original agreement established a loan facility for US \$6.0 million. The interest rate was fixed at 5.5%. The loan term was for five years with monthly interest and principal payment. The loan facility was renewable for an additional five-year period upon approval of Scotiabank El Salvador, S.A. This loan facility has terminated.

In October 2014, our Honduras subsidiary entered into a loan agreement with The Bank of Nova Scotia. The agreement establishes a credit facility for \$3.4 million with a variable interest rate of 30-day LIBOR plus 3.5%. The loan term is for five years with monthly interest and principal payments. The purpose of the loan was to refinance the previously existing loan with ScotiaBank El Salvador, S.A. This loan is secured by assets of the Company's Honduras subsidiary.

Derivatives

We are exposed to certain risks relating to our ongoing business operations. One risk managed by us using derivative instruments is interest rate risk. To manage interest rate exposure, we enter into hedging 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 interest payments associated with variable-rate LIBOR 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, we are exposed to foreign currency and interest rate cash flow exposure related to non-functional currency long-term debt of two of our wholly owned subsidiaries. To manage foreign currency and interest rate cash flow exposure, these subsidiaries enter 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.

We are also exposed to foreign-currency exchange-rate fluctuations on U.S. dollar denominated liabilities within our international subsidiaries whose functional currency is other than the U.S. dollar. We manage these fluctuations, in part, through the use of non-deliverable forward foreign-exchange contracts that are intended to offset changes in cash flow attributable to currency exchange movements. The contracts are intended primarily to economically address exposure to U.S. dollar merchandise inventory expenditures made by our international subsidiaries whose functional currency is other than the U.S. dollar. We seek to mitigate foreign-currency exchange-rate risk with the use of these contracts and do not intend to engage in speculative transactions. Currently, these contracts do not contain any credit-risk-related contingent features. These contracts do not qualify for derivative hedge accounting. The forward currency hedges are not effective cash flow hedges because the notional amount and maturity date of the forward contract does not coincide with the accounts payable balance and due dates. The hedge ineffectiveness is measured by use of the "hypothetical derivative method," and we record the changes in the fair value of the forward contract related to the re-measurement of the payable at spot exchange rates as exchange rate gains or losses. The implied interest rate included within the forward contract is reflected in earnings as interest expense.

Table of Contents

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction is determined to be ineffective. There were no such amounts for the periods reported herein.

The following table summarizes agreements for which the Company has recorded cash flow hedge accounting transactions during the nine months ended May 31, 2016:

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
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	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
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, September, December 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 3.5%	5.16 %	28th day of each month beginning December 29, 2014
Honduras	23-Oct-14	Citibank, N.A. ("Citi")	Cross currency interest rate swap	\$ 5,000,000	Citibank, N.A.	Variable rate 3-month Libor plus	11.60 %	22nd day of January, April, July, and October beginning

Edgar Filing: PRICESMART INC - Form 10-Q

Panama	1-Aug-14	Bank of Nova Scotia ("Scotiabank")	swap Interest rate swap	\$ 5,000,000	Bank of Nova Scotia	3.5% Variable rate 30-day Libor plus 3.5%	4.89 %	on January 22, 2014 21st day of each month beginning September 22, 2014
Panama	22-May-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 19,800,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.98 %	4th day of each month beginning June 4, 2014
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 beginning June 4, 2014

We measure the fair value for all financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis during the reporting period. We have designated the interest rate swaps and cross-currency interest rate swap agreements as hedging instruments and have accounted for them under hedge accounting rules. 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, except footnote data):

Derivatives designated as cash flow hedging instruments	Balance Sheet Location	May 31, 2016			August 31, 2015		
		Fair Value	Net Tax Effect	Net OCI	Fair Value	Net Tax Effect	Net OCI
Cross-currency interest rate swaps(1)	Other non-current assets	\$ 3,889	\$ (236)	\$ (3,653)	\$ 4,129	\$ (1)	\$ (4,128)
Interest rate swaps	Other long-term liabilities	(448)	125	323	(387)	98	289
Cross-currency interest rate swaps	Other long-term liabilities	(1,236)	371	865	(1,312)	482	830
Net fair value of derivatives designated as hedging instruments		\$ 2,205	\$ 260	\$ (2,465)	\$ 2,430	\$ 579	\$ (3,009)

(1) The beneficial tax effect of these swaps is largely offset by a valuation allowance.

Table of Contents

The Company did not settle any derivatives during the nine months ended May 31, 2016. The following table summarizes the derivatives that were settled during the twelve months ended August 31, 2015 (in thousands):

Date	Payment of Derivative Obligation	Foreign Exchange on Derivative Obligation	Recognize Settlement of Derivative Right net of Bank Fees	Swap Derivative (Gain)Loss	
23-Jul-15	\$ 5,141	\$ 2,929	\$ (2,859)	\$ 50	
31-Jul-15	1,343	670	(657)	11	
31-Jul-15	4,029	2,011	(1,971)	21	
6-Aug-15	4,944	3,181	(3,056)	70	
	\$ 15,457	\$ 8,791	\$ (8,543)	\$ 152	(1)

⁽¹⁾ Reclassified from accumulated other comprehensive income (loss) to other income (expense) for settlement of derivative instruments in the amount of \$100,000, net of tax.

From time to time, we enter into non-deliverable forward exchange contracts. These contracts are treated for accounting purposes as fair value contracts and do not qualify for derivative hedge accounting.

The following table summarizes these agreements as of May 31, 2016:

Subsidiary	Dates entered into	Derivative Financial Counter-party	Derivative Financial Instrument	Notional Amount (in thousands)	Settlement Date	Effective Period of Forward
Costa Rica	31-Aug-15	Citibank, N.A.	Forward foreign exchange contracts	\$ 3,750	August 30, 2016	August 31, 2015- August 30, 2016

The following table summarizes the fair value of foreign currency forward contracts that do not qualify for derivative hedge accounting (in thousands):

Derivatives designated as fair value hedging instruments	May 31, 2016		August 31, 2015	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Foreign currency forward contracts	Other accrued expenses	\$ (192)	Other accrued expenses	\$ (66)
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting		\$ (192)		\$ (66)

Short-Term Borrowings and Long-Term Debt

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

	Total Amount of Facilities	Facilities Used		Facilities Available	Weighted average interest rate	
		Short-term Borrowings	Letters Credit			
May 31, 2016	\$ 64,993	\$ 10,127	\$ 9,258	\$ 45,608	6.7	%
August 31, 2015	\$ 57,691	\$ 6,606	\$ 728	\$ 50,357	5.9	%

As of May 31, 2016 and August 31, 2015, the Company had approximately \$40.0 million of short-term facilities in the U.S. that require compliance with certain quarterly financial covenants. As of May 31, 2016 and August 31, 2015, the Company was in compliance with respect to these covenants. Each of the facilities expires annually and is normally renewed.

Table of Contents

The following table provides the changes in our long-term debt for the nine months ended May 31, 2016:

	Current	Long-term	
	portion of	debt (net of	
(Amounts in thousands)	long-term debt	current	Total
Balances as of August 31, 2015	\$ 17,169	\$ 73,365	\$ 90,534 (1)
Proceeds from long-term debt incurred during the period:			
Costa Rica subsidiary	—	7,370	7,370
Repayments of long-term debt:			
Regularly scheduled loan payments	(553)	(9,638)	(10,191)
Reclassifications of long-term debt	(731)	731	—
Translation adjustments on foreign-currency debt of subsidiaries whose functional currency is not the U.S. dollar (2)	214	(366)	(152)
Balances as of May 31, 2016	\$ 16,099	\$ 71,462	\$ 87,561 (3)

- (1) The carrying amount on non-cash assets assigned as collateral for this total was \$104.1 million. No cash assets were assigned as collateral for this total.
- (2) These foreign currency translation adjustments are recorded within Other comprehensive income.
- (3) The carrying amount on non-cash assets assigned as collateral for this total was \$100.0 million. No cash assets were assigned as collateral for this total.

As of May 31, 2016, the Company had approximately \$75.0 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 May 31, 2016, the Company was in compliance with all covenants or amended covenants.

As of August 31, 2015, the Company had approximately \$85.0 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, 2015, the Company was in compliance with all covenants or amended covenants.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements that have had, or are reasonably likely to have, a material current or future effect on its financial condition or consolidated financial statements.

Repurchase of Equity Securities and Reissuance of Treasury Shares

At the vesting dates for restricted stock awards to our employees, we repurchase a portion of the shares that have vested at the prior day's closing price per share, with the funds used to pay the employees' minimum statutory tax withholding requirements related to the vesting of restricted stock awards. We do not have a stock repurchase program.

Shares of common stock repurchased by us are recorded at cost as treasury stock and result in the reduction of stockholders' equity in our Consolidated Balance Sheets. We may reissue these treasury shares. When treasury shares are reissued, we use the first in/first out ("FIFO") cost method for determining cost of the reissued shares. If the issuance price is higher than the cost, the excess of the issuance price over the cost is credited to additional paid-in capital ("APIC"). If the issuance price is lower than the cost, the difference is first charged against any credit balance in APIC from treasury stock and the balance is charged to retained earnings.

The following table summarizes the shares repurchased during fiscal years 2016 and 2015:

	Nine Months Ended	
	May 31, 2016	May 31, 2015
Shares repurchased	27,360	50,639
Cost of repurchase of shares (in thousands)	\$ 2,017	\$ 4,500

Table of Contents

We have reissued treasury shares as part of our stock-based compensation programs. However, as summarized below, no treasury shares were reissued during the periods presented:

	Nine Months Ended May 31 , 2016 2015	
Reissued treasury shares	—	—

Critical Accounting Estimates

The preparation of our consolidated financial statements requires that management make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Some of our accounting policies require management to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Management continues to review its accounting policies and evaluate its estimates, including those related to contingencies and litigation, income taxes, value added taxes, and long-lived assets. We base our estimates on historical experience and on other assumptions that management believes to be reasonable under the present circumstances. Using different estimates could have a material impact on our financial condition and results of operations.

Contingencies and Litigation: In the ordinary course of business, we are periodically named as a defendant in various lawsuits, claims and pending actions and are exposed to tax risks (other than income tax). The principal risks that we insure against are workers' compensation, general liability, vehicle liability, property damage, employment practices, errors and omissions, fiduciary liability and fidelity losses. If a potential loss arising from these lawsuits, claims, actions and non-income tax issues is probable and reasonably estimable, we record the estimated liability based on circumstances and assumptions existing at the time. The estimates affecting our litigation reserves can be affected by new claims filed after the balance sheet date with respect to events occurring prior to the balance sheet date and developments in pending litigation that may affect the outcome of the litigation. While we believe the recorded liabilities are adequate, there are inherent limitations in projecting the outcome of litigation and in evaluating the probable additional tax associated with various non-income tax filing positions. As such, we are unable to make a reasonable estimate of the sensitivity to change of estimates affecting our recorded liabilities. As additional information becomes available, we assess the potential liability and revise our estimates as appropriate.

Income Taxes: We account 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 attributable 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. As of May 31, 2016, we evaluated our deferred tax assets and liabilities and determined that a valuation allowance was necessary for certain foreign deferred tax asset balances, primarily because of the existence of significant negative objective evidence, such as the fact that certain subsidiaries are in a cumulative loss position for the past three years, indicating that certain net operating loss carry-forward periods are not sufficient to realize the related deferred tax assets.

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

We accrue an amount for our 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. This requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. When facts and circumstances change, we reassess these probabilities and record any changes in the consolidated financial statements as appropriate. There were no material changes in our uncertain income tax positions for the periods ended on May 31, 2016 and August 31, 2015. During the first quarter of fiscal year 2015, one of the Company’s subsidiaries received provisional assessments claiming \$2.5 million of taxes, penalties and interest related to withholding taxes on certain charges for services rendered by the Company. In addition, during the first quarter of fiscal year 2015, this subsidiary received provisional assessments totaling \$5.2 million for lack of deductibility of the underlying service charges due to the lack

Table of Contents

of withholding. Based on the Company's interpretation of local law, rulings and jurisprudence (including Supreme Court precedents with respect to the deductibility assessment), the Company expects to prevail in both instances and has not recorded a provision for these assessments.

We have not provided for U.S. deferred taxes on cumulative non-U.S. undistributed earnings as we deem such earnings to be indefinitely reinvested. It is not practicable to determine the U.S. federal income tax liability that would be associated with the repatriation earnings because of the complexity of the computation.

Tax Receivables: We pay Value Added Tax (“VAT”) or similar taxes (“input VAT”), income taxes, and other taxes within the normal course of our business in most of the countries in which we operate related to the procurement of merchandise and/or services we acquires and/or on sales and taxable income. We also collect VAT or similar taxes on behalf of the government (“output VAT”) for merchandise and/or services we sell. 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 we operate, the governments have implemented additional collection procedures, such as requiring credit card processors to remit a portion of sales processed via credit card directly to the government as advance payments of VAT and/or income tax. In the case of VAT, these procedures alter the natural offset of input and output VAT and generally leave us with a net VAT receivable, forcing us 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. We either request a refund of these tax receivables or apply 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 we operate, the tax refund process is defined and structured with regular refunds or offsets. However, in three countries the governments have alleged that and/or there is not a clearly defined process in the laws and regulations to allow the authorities to refund VAT receivables. We, together with our tax and legal advisers, are currently appealing these interpretations in court and expect to prevail. In one of these countries, where there is recent favorable jurisprudence, the government performed an audit to verify the amount of the respective VAT receivables as a required precursor to any refund. The balance of the VAT receivable in these countries was \$6.9 million and \$6.5 million as of May 31, 2016 and August 31, 2015, respectively. In another country in which the Company has warehouse clubs, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires us to pay taxes based on a percentage of sales rather than income. As a result, we are making income tax payments substantially in excess of those we would expect to pay based on taxable income. The current rules (which we have challenged in court) do not clearly allow us to obtain a refund or offset this excess income tax against other taxes. As of May 31, 2016, the Company had deferred tax assets of approximately \$1.7 million in this country. Also, the Company had an income tax receivable balance of \$2.2 million as of May 31, 2016, related to excess payments from fiscal year 2015. We have not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets because we believe that it is more likely than not that we will succeed in our refund request and/or court challenge on this matter.

Our 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 our subsidiary has generally demonstrated the ability to recover the VAT or income tax receivable within one year. We also classify as short-term any approved refunds or credit notes to the extent that we expect 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 our 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 we do not expect to eventually prevail in its recovery.

Long-lived Assets: We periodically evaluate our long-lived assets for indicators of impairment. Indicators that an asset may be impaired are:

- the asset's inability to continue to generate income from operations and positive cash flow in future periods;
- loss of legal ownership or title to the asset;
- significant changes in its strategic business objectives and utilization of the asset(s); and
- the impact of significant negative industry or economic trends.

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, which in turn drives estimates of future cash flows from these assets. These periodic evaluations could cause management to conclude that impairment factors exist, requiring an adjustment of these assets to their then-current fair market value. Future business conditions and/or activity could differ materially from the projections made by management causing the need for additional impairment charges. No impairment charges have been

Table of Contents

recorded during fiscal year 2016 related to the loss of legal ownership or title to assets; significant changes in the Company's strategic business objectives or utilization of assets; or the impact of significant negative industry or economic trends. Loss/(gain) on disposal of assets recorded during the years reported resulted from improvements to operations and normal preventive maintenance.

Seasonality

Historically, our merchandising businesses have experienced holiday retail seasonality in their markets. In addition to seasonal fluctuations, our operating results fluctuate quarter-to-quarter as a result of economic and political events in markets that we serve, the timing of holidays, weather, the timing of shipments, product mix, and currency effects on the cost of U.S.-sourced products which may make these products more or less expensive in local currencies and therefore more or less affordable. Because of such fluctuations, the results of operations of any quarter are not indicative of the results that may be achieved for a full fiscal year or any future quarter. In addition, there can be no assurance that our future results will be consistent with past results or the projections of securities analysts.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risks relating to our operations result primarily from changes in interest rates and changes in currency exchange rates. There have been no material changes in our market risk factors at May 31, 2016 compared to those disclosed in our Annual Report on Form 10-K for the fiscal year ended August 31, 2015. The gross fair value of our derivative financial instruments designated as cash flow hedges have decreased by \$225,000 since August 31, 2015, primarily due to fluctuation of the currencies that are being hedged and the scheduled maturities of the underlying instruments during the nine months ended May 31, 2016. Movements in currency exchange rates and the related impact on the translation of the balance sheets of the Company's subsidiaries whose functional currency is not the U.S. dollar were the primary cause of the \$6.5 million net gain and \$4.4 million net loss for the three and nine months, respectively ended May 31, 2016 in the foreign currency translation adjustments category of accumulated other comprehensive income (loss).

In addition, the Company's subsidiaries whose functional currency is not the U.S. dollar carry 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 currency gain (loss) within Other income (expense) in the consolidated statements of income.

Edgar Filing: PRICESMART INC - Form 10-Q

The following table summarizes the amounts recorded for the three and nine month period ending May 31, 2016 and 2015 (in thousands):

	Three Months		Nine Months Ended	
	Ended		May 31,	May 31,
	May 31,	May 31,	May 31,	May 31,
	2016	2015	2016	2015
Currency gain (loss)	\$ (222)	\$ (311)	\$ (1,018)	\$ (4,602)

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the timelines specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decision regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, we have investments in certain unconsolidated entities. Because we do not control or manage those entities, our control procedures with respect to those entities were substantially more limited than those we maintain with respect to our consolidated subsidiaries.

As required by SEC Rules 13a-15(e) or 15d-15(e), we carried out an evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon their evaluation, the Principal Executive Officer and Principal Financial Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level.

In the ordinary course of business, we review our system of internal control over financial reporting and make changes to our systems and processes to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems and automating manual processes. There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

The certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 are filed as Exhibit 31.1 and 31.2 to this report.

Table of Contents

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this Quarterly Report on Form 10-Q, the reader should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended August 31, 2015. There have been no material changes in the Company's risk factors from those disclosed in Part I, Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2015.

Available Information

The PriceSmart, Inc. website or internet address is www.pricessmart.com. On this website the Company makes available, free of charge, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports, and the annual report to the security holders as soon as reasonably practicable after electronically filing such material with or furnishing it to the U.S. Securities and Exchange Commission (SEC). The Company’s SEC reports can be accessed through the investor relations section of its website under “SEC Filings.” All of the Company’s filings with the SEC may also be obtained at the SEC’s Public Reference Room at Room 1580, 100 F Street NE, Washington, DC 20549. For information regarding the operation of the SEC’s Public Reference Room, please contact the SEC at 1-800-SEC-0330. Additionally, the SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at www.sec.gov. The Company made available its annual report on Form 10-K and its annual Proxy Statement for the fiscal year 2015 at the internet address <http://materials.proxyvote.com/741511>.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) None.

(b) None.

(c) Purchase of Equity Securities by the Issuer and Affiliated Purchasers.

Upon vesting of restricted stock awarded by the Company to employees, the Company repurchases shares and withholds the amount of the repurchase payment to cover employees' tax withholding obligations. The Company does not have a stock repurchase program. The table below summarizes shares repurchased during the quarter.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
March 1, 2016 - March 31, 2016	723	\$ 83.75	—	N/A
April 1, 2016 - April 30, 2016	—	\$ —	—	N/A
May 1, 2016 - May 31, 2016	—	\$ —	—	N/A
Total	723	\$ 83.75	—	—

Table of Contents

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

64

Table of Contents

ITEM 6. EXHIBITS

(a) Exhibits:

- 3.1(1) Amended and Restated Certificate of Incorporation of the Company.
- 3.2(2) Certificate of Amendment of Amended and Restated Certificate of Incorporation of the Company.
- 3.3(3) Certificate of Amendment of Amended and Restated Certificate of Incorporation of the Company.
- 3.4(1) Amended and Restated Bylaws of the Company.
- 31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1** Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2** Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Identifies management contract or compensatory plan or arrangement.

** These certifications are being furnished solely to accompany this Report pursuant to 18 U.S.C. 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and are not to be incorporated by reference into any filing of PriceSmart, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.

- (1) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended August 31, 1997 filed with the Commission on November 26, 1997.
- (2) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended February 29, 2004 filed with the Commission on April 14, 2004.
- (3) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended August 31, 2004 filed with the Commission on November 24, 2004.
- (4) Incorporated by reference to the Form 8-K filed with the Commission on September 2, 2015.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PRICESMART, INC.

Date: July 7, 2016 By: /s/ JOSE LUIS LAPARTE
Jose Luis Laparte
Director, Chief Executive Officer and President
(Principal Executive Officer)

Date: July 7, 2016 By: /s/ JOHN M. HEFFNER
John M. Heffner
Executive Vice President and Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)