

Container Store Group, Inc.  
Form 10-Q  
August 02, 2018  
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2018

OR

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

For the transition period from                      to

Commission File Number: 001-36161

THE CONTAINER STORE GROUP, INC.

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of incorporation or organization)

26-0565401  
(IRS Employer Identification No.)

500                                      75019

Freeport  
Parkway,  
Coppell, TX  
(Addresses  
of principal  
executive offices)

(Zip  
Codes)

Registrant's telephone number in the United States, including area code, is: (972) 538-6000

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer      Accelerated filer                      Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company      Emerging growth company

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
No

The registrant had 48,848,665 shares of its common stock outstanding as of July 27, 2018.

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Table of Contents

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Unaudited Consolidated Balance Sheets as of June 30, 2018, March 31, 2018, and July 1, 2017 3

Unaudited Consolidated Statements of Operations for the Thirteen Weeks ended June 30, 2018 and July 1, 2017

Unaudited Consolidated Statements of Comprehensive Income (Loss) for the Thirteen Weeks ended June 30, 2018 and July 1, 2017 6

Unaudited Consolidated Statements of Cash Flows for the Thirteen Weeks ended June 30, 2018 and July 1, 2017

Notes to the Unaudited Consolidated Financial Statements 8

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations 18

Item 3. Quantitative and Qualitative Disclosures About Market Risk 31

Item 4. Controls and Procedures 31

PART II. OTHER INFORMATION

Item 1. Legal Proceedings 32

Item 1A. Risk Factors 32

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 32

Item 3. Default Upon Senior Securities 32

Item 4. Mine Safety Disclosures 32

Item 5. Other Information 32

Item 6. Exhibits 33



Table of Contents

The Container Store Group, Inc.

Consolidated balance sheets

| (In thousands)                      | June 30,<br>2018<br>(unaudited) | March 31,<br>2018 | July 1,<br>2017<br>(unaudited) |
|-------------------------------------|---------------------------------|-------------------|--------------------------------|
| Assets                              |                                 |                   |                                |
| Current assets:                     |                                 |                   |                                |
| Cash                                | \$ 14,102                       | \$ 8,399          | \$ 7,216                       |
| Accounts receivable, net            | 24,840                          | 25,528            | 27,490                         |
| Inventory                           | 104,135                         | 97,362            | 105,006                        |
| Prepaid expenses                    | 10,842                          | 11,281            | 16,131                         |
| Income taxes receivable             | 812                             | 15                | 668                            |
| Other current assets                | 12,577                          | 11,609            | 13,683                         |
| Total current assets                | 167,308                         | 154,194           | 170,194                        |
| Noncurrent assets:                  |                                 |                   |                                |
| Property and equipment, net         | 151,455                         | 158,389           | 163,876                        |
| Goodwill                            | 202,815                         | 202,815           | 202,815                        |
| Trade names                         | 226,613                         | 229,401           | 229,009                        |
| Deferred financing costs, net       | 294                             | 312               | 297                            |
| Noncurrent deferred tax assets, net | 2,101                           | 2,404             | 2,226                          |
| Other assets                        | 1,777                           | 1,854             | 1,824                          |
| Total noncurrent assets             | 585,055                         | 595,175           | 600,047                        |
| Total assets                        | \$ 752,363                      | \$ 749,369        | \$ 770,241                     |

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated balance sheets (continued)

| (In thousands, except share and per share amounts)   | June 30,<br>2018<br>(unaudited) | March 31,<br>2018 | July 1,<br>2017<br>(unaudited) |
|--|---------------------------------|-------------------|--------------------------------|
| Liabilities and shareholders' equity   |                                 |                   |                                |
| Current liabilities:   |                                 |                   |                                |
| Accounts payable   | \$ 52,215                       | \$ 43,692         | \$ 43,445                      |
| Accrued liabilities  | 69,828                          | 70,494            | 69,601                         |
| Revolving lines of credit  | 889                             | —                 | 2,729                          |
| Current portion of long-term debt  | 7,780                           | 7,771             | 5,448                          |
| Income taxes payable   | 2,019                           | 4,580             | 1,297                          |
| Other current liabilities  | 1,989                           | —                 | —                              |
| Total current liabilities  | 134,720                         | 126,537           | 122,520                        |
| Noncurrent liabilities:  |                                 |                   |                                |
| Long-term debt   | 291,038                         | 277,394           | 316,375                        |
| Noncurrent deferred tax liabilities, net   | 49,378                          | 54,839            | 77,712                         |
| Deferred rent and other long-term liabilities  | 41,337                          | 41,892            | 33,742                         |
| Total noncurrent liabilities   | 381,753                         | 374,125           | 427,829                        |
| Total liabilities  | 516,473                         | 500,662           | 550,349                        |
| Commitments and contingencies (Note 5)   |                                 |                   |                                |
| Shareholders' equity:  |                                 |                   |                                |
| Common stock, \$0.01 par value, 250,000,000 shares authorized;<br>48,138,907 shares issued at June 30, 2018; 48,072,187 shares issued<br>at March 31, 2018; 48,052,900 shares issued at July 1, 2017 | 481                             | 481               | 481                            |
| Additional paid-in capital   | 861,726                         | 861,263           | 859,638                        |
| Accumulated other comprehensive loss   | (24,239)                        | (17,316)          | (17,401)                       |
| Retained deficit   | (602,078)                       | (595,721)         | (622,826)                      |
| Total shareholders' equity   | 235,890                         | 248,707           | 219,892                        |
| Total liabilities and shareholders' equity   | \$ 752,363                      | \$ 749,369        | \$ 770,241                     |

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated statements of operations

| (In thousands, except share and per share amounts) (unaudited)                          | Thirteen Weeks Ended |                 |
|---|----------------------|-----------------|
|   | June 30,<br>2018     | July 1,<br>2017 |
| Net sales   | \$ 195,823           | \$ 183,068      |
| Cost of sales (excluding depreciation and amortization)                                 | 81,052               | 79,458          |
| Gross profit  | 114,771              | 103,610         |
| Selling, general, and administrative expenses (excluding depreciation and amortization) | 106,605              | 96,640          |
| Stock-based compensation  | 586                  | 494             |
| Pre-opening costs   | 346                  | 1,386           |
| Depreciation and amortization   | 9,337                | 9,542           |
| Other expenses  | 193                  | 3,534           |
| Loss on disposal of assets  | 40                   | 51              |
| Loss from operations  | (2,336)              | (8,037)         |
| Interest expense  | 7,908                | 4,225           |
| Loss before taxes   | (10,244)             | (12,262)        |
| Benefit for income taxes  | (3,480)              | (4,585)         |
| Net loss  | \$ (6,764)           | \$ (7,677)      |
| Net loss per common share—basic and diluted   | \$ (0.14)            | \$ (0.16)       |
| Weighted-average common shares—basic and diluted  | 48,138,907           | 48,047,937      |

See accompanying notes.



Table of Contents

The Container Store Group, Inc.

Consolidated statements of comprehensive loss

| (In thousands) (unaudited)   | Thirteen Weeks Ended |                 |
|--|----------------------|-----------------|
|  | June 30,<br>2018     | July 1,<br>2017 |
| Net loss   | \$ (6,764)           | \$ (7,677)      |
| Unrealized (loss) gain on financial instruments, net of tax (benefit) provision of (\$566) and \$894 | (1,785)              | 1,390           |
| Pension liability adjustment   | 153                  | (110)           |
| Foreign currency translation adjustment  | (5,291)              | 3,962           |
| Comprehensive loss   | \$ (13,687)          | \$ (2,435)      |

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated statements of cash flows

| (In thousands) (unaudited)  | Thirteen Weeks Ended |                 |
|---|----------------------|-----------------|
|   | June 30,<br>2018     | July 1,<br>2017 |
| Operating activities  |                      |                 |
| Net loss  | \$ (6,764)           | \$ (7,677)      |
| Adjustments to reconcile net loss to net cash used in operating activities: |                      |                 |
| Depreciation and amortization   | 9,337                | 9,542           |
| Stock-based compensation  | 586                  | 494             |
| Loss on disposal of assets  | 40                   | 51              |
| Deferred tax benefit  | (3,874)              | (4,573)         |
| Noncash interest  | 759                  | 480             |
| Other   | —                    | 195             |
| Changes in operating assets and liabilities:                                |                      |                 |
| Accounts receivable   | 110                  | 744             |
| Inventory   | (9,975)              | (350)           |
| Prepaid expenses and other assets   | (198)                | (6,565)         |
| Accounts payable and accrued liabilities                                    | 10,030               | 5,937           |
| Income taxes  | (3,303)              | (2,120)         |
| Other noncurrent liabilities  | (68)                 | (939)           |
| Net cash used in operating activities                                       | (3,320)              | (4,781)         |
| Investing activities  |                      |                 |
| Additions to property and equipment   | (4,456)              | (5,181)         |
| Proceeds from sale of property and equipment                                | 1                    | 2               |
| Net cash used in investing activities                                       | (4,455)              | (5,179)         |
| Financing activities  |                      |                 |
| Borrowings on revolving lines of credit                                     | 7,581                | 4,876           |
| Payments on revolving lines of credit                                       | (6,663)              | (2,261)         |
| Borrowings on long-term debt  | 15,000               | 5,000           |
| Payments on long-term debt and capital leases                               | (1,954)              | (1,350)         |
| Payment of taxes with shares withheld upon restricted stock vesting         | (122)                | (39)            |
| Net cash provided by financing activities                                   | 13,842               | 6,226           |
| Effect of exchange rate changes on cash                                     | (364)                | 214             |
| Net increase (decrease) in cash   | 5,703                | (3,520)         |
| Cash at beginning of fiscal period  | 8,399                | 10,736          |
| Cash at end of fiscal period  | \$ 14,102            | \$ 7,216        |
| Supplemental information for non-cash investing and financing activities:   |                      |                 |
| Purchases of property and equipment (included in accounts payable)          | \$ 852               | \$ 1,148        |

|                                   |      |       |
|-----------------------------------|------|-------|
| Capital lease obligation incurred | \$ 4 | \$ 36 |
|-----------------------------------|------|-------|

See accompanying notes.

7

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Table of Contents

The Container Store Group, Inc.

Notes to consolidated financial statements (unaudited)

(In thousands, except share amounts and unless otherwise stated)

June 30, 2018

1. Description of business and basis of presentation

These financial statements should be read in conjunction with the financial statement disclosures in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the Securities and Exchange Commission on May 31, 2018. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). We use the same accounting policies in preparing quarterly and annual financial statements. All adjustments necessary for a fair presentation of quarterly operating results are reflected herein and are of a normal, recurring nature.

Description of business

The Container Store, Inc. was founded in 1978 in Dallas, Texas, as a retailer with a mission to provide customers with storage and organization solutions through an assortment of innovative products and unparalleled customer service. In 2007, The Container Store, Inc. was sold to The Container Store Group, Inc. (the “Company”), a holding company, of which a majority stake was purchased by Leonard Green and Partners, L.P. (“LGP”), with the remainder held by certain employees of The Container Store, Inc. On November 6, 2013, the Company completed its initial public offering (the “IPO”). As the majority shareholder, LGP retains controlling interest in the Company. As of June 30, 2018, The Container Store, Inc. operates 91 stores with an average size of approximately 25,000 square feet (19,000 selling square feet) in 32 states and the District of Columbia. The Container Store, Inc. also offers all of its products directly to its customers, including business-to-business customers, through its website and call center. The Container Store, Inc.’s wholly-owned Swedish subsidiary, Elfa International AB (“Elfa”), designs and manufactures component-based shelving and drawer systems and made-to-measure sliding doors. elfa® branded products are sold exclusively in the United States in The Container Store retail stores, website and call center, and Elfa sells to various retailers on a wholesale basis in approximately 30 countries around the world, with a concentration in the Nordic region of Europe.

Seasonality

The Company’s business is moderately seasonal in nature and, therefore, the results of operations for the thirteen weeks ended June 30, 2018 are not necessarily indicative of the operating results for the full year. The Company has

historically realized a higher portion of net sales, operating income, and cash flows from operations in the fourth fiscal quarter, attributable primarily to the timing and impact of Our Annual elfa® Sale, which traditionally starts on or about December 24 and runs into February.

#### Revenue recognition

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, an updated standard on revenue recognition. The Company adopted this standard in the first quarter of fiscal 2018 and elected to use the modified-retrospective approach for implementation of the standard. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the Company expects to be entitled in exchange for those goods or services.

The Company has identified certain impacts to our accounting for gift cards given away for promotional or marketing purposes. Under previous GAAP, the value of promotional gift cards was recorded as selling, general, and administrative expense. The new standard requires these types of gift cards to be accounted for as a reduction of revenue (i.e. a discount). Additionally, ASU 2014-09 disallows the capitalization of direct-response advertising costs which will impact the timing of recognition of certain advertising production and distribution costs.

Upon transition on April 1, 2018, the Company recorded a cumulative adjustment to increase retained earnings/(deficit) and to decrease accrued liabilities by approximately \$400. The Company also reclassified the asset balance for the

Table of Contents

estimate of future returned merchandise, which was approximately \$900 as of March 31, 2018, from the "Inventory" line to the "Other current assets" line on the balance sheet. Overall, the adoption of ASU 2014-09 did not result in a material impact to the Company's financial statements. Note 9 provides the related disaggregated revenue disclosures.

We recognize revenues and the related cost of goods sold for our TCS segment when merchandise is received by our customers, which reflects an estimate of shipments that have not yet been received by the customer. This estimate is based on shipping terms and historical delivery times. We recognize revenues and the related cost of goods sold for our Elfa segment upon shipment. We recognize shipping and handling fees as revenue when the merchandise is shipped to the customer. Costs of shipping and handling are included in cost of goods sold. We recognize fees for installation and other services as revenue upon completion of the service to the customer. Costs of installation and other services are included in cost of goods sold. Sales tax collected is not recognized as revenue as it is ultimately remitted to governmental authorities. We reserve for projected merchandise returns based on historical experience and various other assumptions that we believe to be reasonable. The reserve reduces sales and cost of sales, accordingly. Merchandise exchanges of similar product and price are not considered merchandise returns and, therefore, are excluded when calculating the sales returns reserve.

Contract Balances

Contract balances as a result of transactions with customers primarily consist of trade receivables included in Accounts receivable, net, unearned revenue included in Accrued liabilities, and gift cards and store credits outstanding included in Accrued liabilities in the Company's Consolidated Balance Sheets. Note 2 provides the Company's trade receivables, unearned revenue, and gift cards and store credits outstanding with customers as of June 30, 2018, March 31, 2018, and July 1, 2017.

Below is a rollforward of contract liability balances from March 31, 2018 to June 30, 2018, which illustrates the amount of contract liability as of March 31, 2018 which was subsequently recognized into revenue in the thirteen weeks ended June 30, 2018:

|  | Contract liability | Revenue recognized from beginning liability | Contract liabilities added during period (2) | Contract liability balance at June 30, 2018 |
|--|--------------------|---|--|---|
| Unearned revenue                         | \$ 11,080          | \$ (10,028)                                 | \$ 13,591                                    | \$ 14,643                                   |
| Gift cards and store credits outstanding | \$ 8,470           | \$ (1,123)                                  | \$ 1,338                                     | \$ 8,685                                    |

(1) Gift cards and store credits outstanding balance is net of revenue recognition transition adjustment

(2) Net of estimated breakage

Recent accounting pronouncements

In October 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory, which requires entities to recognize the income tax effects of intercompany sales and transfers of assets, other than inventory, in the period in which the transfer occurs. This is a change from current GAAP, which requires entities to defer the income tax effects of intercompany transfers of assets until the asset has been sold to an outside party or otherwise recognized (i.e. depreciated, amortized, impaired). The income tax effects of intercompany sales and transfers of inventory will continue to be deferred until the inventory is sold to an outside party. This ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those years, with early adoption permitted. The Company adopted ASU 2016-16 in the first quarter of fiscal 2018. The adoption of this standard did not result in a material impact to the Company’s financial statements.

In March 2017, the FASB issued ASU 2017-07, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which provides guidance that

Table of Contents

requires an employer to present the service cost component separate from the other components of net periodic benefit cost. The update requires that employers present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered by participating employees during the period. The other components of the net periodic benefit cost are required to be presented separately from the line item that includes service cost and outside of the subtotal of income from operations. If a separate line item is not used, the line item used in the income statement must be disclosed. In addition, only the service cost component is eligible for capitalization in assets. The Company adopted ASU 2017-07 in the first quarter of fiscal 2018 on a retrospective basis. The adoption of this standard did not result in a material impact to the Company's financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting, which clarifies when modification accounting should be applied for changes to terms or conditions of a share-based payment award. The Company adopted ASU 2017-09 in the first quarter of fiscal 2018 on a prospective basis. The adoption of this standard did not result in a material impact to the Company's financial statements.

In February 2016, the Financial Accounting Standard Board issued Accounting Standards Update 2016-02, Leases (Topic 842), to revise lease accounting guidance. The update requires most leases to be recorded on the balance sheet as a lease liability, with a corresponding right-of-use asset, whereas these leases currently have an off-balance sheet classification. ASU 2016-02 must be applied on a modified retrospective basis and is effective for fiscal years beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. The Company currently intends to adopt this standard in the first quarter of fiscal 2019. The Company is still evaluating the impact of implementation of this standard on its financial statements, but expects that adoption will have a material impact to the Company's total assets and liabilities given the Company has a significant number of operating leases not currently recognized on its balance sheet.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, which is intended to improve and simplify hedge accounting and improve the disclosures of hedging arrangements. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact of adopting the new standard on its financial statements.

In June 2018, the FASB issued ASU 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which simplifies the accounting for share-based payments granted to nonemployees for goods and services. Under this ASU, the guidance on share-based payments to nonemployees would be aligned with the requirements for share-based payments granted to employees, with certain exceptions. This ASU is effective for fiscal years beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. The Company is currently evaluating the impact of adopting the new standard on its financial statements.





Table of Contents

## 2. Detail of certain balance sheet accounts

|  | June 30,<br>2018 | March 31,<br>2018 | July 1,<br>2017 |
|--|------------------|-------------------|-----------------|
| Accounts receivable, net:                |                  |                   |                 |
| Trade receivables, net                   | \$ 12,898        | \$ 15,968         | \$ 13,964       |
| Credit card receivables                  | 10,054           | 6,939             | 9,474           |
| Tenant allowances                        | 235              | 998               | 2,929           |
| Other receivables                        | 1,653            | 1,623             | 1,123           |
|  | \$ 24,840        | \$ 25,528         | \$ 27,490       |
| Inventory:                               |                  |                   |                 |
| Finished goods                           | \$ 98,851        | \$ 91,970         | \$ 100,036      |
| Raw materials                            | 4,663            | 4,840             | 4,440           |
| Work in progress                         | 621              | 552               | 530             |
|  | \$ 104,135       | \$ 97,362         | \$ 105,006      |
| Accrued liabilities:                     |                  |                   |                 |
| Accrued payroll, benefits and bonuses    | \$ 25,177        | \$ 24,940         | \$ 25,207       |
| Unearned revenue                         | 14,643           | 11,080            | 12,284          |
| Accrued transaction and property tax     | 9,366            | 12,846            | 10,859          |
| Gift cards and store credits outstanding | 8,685            | 8,891             | 9,394           |
| Accrued lease liabilities                | 4,619            | 5,105             | 5,311           |
| Accrued interest                         | 258              | 292               | 182             |
| Other accrued liabilities                | 7,080            | 7,340             | 6,364           |
|  | \$ 69,828        | \$ 70,494         | \$ 69,601       |

## 3. Net income (loss) per common share

Basic net income (loss) per common share is computed as net income (loss) divided by the weighted-average number of common shares for the period. Diluted net income (loss) per share is computed as net income (loss) divided by the weighted-average number of common shares for the period plus common stock equivalents consisting of shares subject to stock-based awards with exercise prices less than or equal to the average market price of the Company's common stock for the period, to the extent their inclusion would be dilutive. Potentially dilutive securities are excluded from the computation of diluted net income (loss) per share if their effect is anti-dilutive.

The following is a reconciliation of net loss and the number of shares used in the basic and diluted net loss per share calculations:

|  | Thirteen Weeks Ended |                 |
|--|----------------------|-----------------|
|  | June 30,<br>2018     | July 1,<br>2017 |
| Numerator:                                       |                      |                 |
| Net loss   | \$ (6,764)           | \$ (7,677)      |
| Denominator:                                     |                      |                 |
| Weighted-average common shares-basic and diluted | 48,138,907           | 48,047,937      |
| Net loss per common share-basic and diluted      | \$ (0.14)            | \$ (0.16)       |
| Antidilutive securities not included:            |                      |                 |
| Stock options outstanding                        | 2,598,505            | 2,932,907       |
| Nonvested restricted stock awards                | 123,001              | 83,509          |

Table of Contents

4. Income taxes

The benefit for income taxes in the thirteen weeks ended June 30, 2018 was \$3,480 as compared to a benefit of \$4,585, in the thirteen weeks ended July 1, 2017. The effective tax rate for the thirteen weeks ended June 30, 2018 was 34.0%, as compared to 37.4% in the thirteen weeks ended July 1, 2017. During the thirteen weeks ended June 30, 2018, the effective tax rate rose above the U.S. statutory rate primarily due to the recognition of a \$604 tax benefit for the remeasurement of deferred tax balances as a result of a change in the Swedish tax rate with a pre-tax loss in the quarter, the impact of the global intangible low-taxed income ("GILTI") provision from the Tax Cuts and Jobs Act enacted in fiscal 2017, and U.S. state income taxes. During the thirteen weeks ended July 1, 2017, the effective tax rate rose above the U.S. statutory rate primarily due to U.S. state income taxes, partially offset by lower income taxes on earnings sourced in foreign jurisdictions.

Tax Cuts and Jobs Act (the "Tax Act")

The Company recorded a net provisional tax benefit in fiscal 2017 related to the Tax Act of \$15,689, which includes a provisional benefit of \$24,210 related to the remeasurement of the Company's deferred tax balances, partially offset by a provisional expense of \$8,521 related to the one-time transition tax on foreign earnings. Pursuant to Staff Accounting Bulletin ("SAB") No. 118 ("SAB 118"), the Company's measurement period for implementing the accounting changes required by the Tax Act will close before December 22, 2018 and the Company anticipates completing the accounting under Accounting Standards Codification ("ASC") Topic 740, Income Taxes ("ASC 740") in a subsequent reporting period within the measurement period.

The Company believes the remeasurement of its deferred tax balances is complete, except for changes in estimates that may result from finalizing the filing of its 2017 U.S. income tax return and changes that may be a direct impact of changes to other provisional amounts due to the enactment of the Tax Act. In addition, the estimate may be impacted as the Company further analyzes state tax conformity to the federal tax changes and guidance issued by regulatory bodies that provide interpretive guidance of the Tax Act. Any adjustments to the provisional amounts will be recognized as a component of the provision for income taxes in the period in which such adjustments are determined within the measurement period. Additionally, the Company is continuing to gather additional information to be able to more precisely compute the final amount of the one-time transition tax on foreign earnings.

The Tax Act creates a new requirement that certain GILTI earned by controlled foreign corporations ("CFC") must be included currently in the taxable income of the CFC's U.S. shareholder. The Company became subject to the GILTI provisions beginning in fiscal 2018. Because of the complexity of the new GILTI tax rules, the Company is continuing to evaluate this provision of the Tax Act and the application of ASC 740. The Company has not yet elected an accounting policy to determine whether it will recognize GILTI as a period cost when incurred or to recognize deferred taxes for basis differences expected to reverse. For purposes of calculating the estimated annual effective tax rate at quarter end, the Company has used the period cost method. The Company will continue to assess the appropriateness of this method during the period allowed for under SAB 118.

5. Commitments and contingencies

In connection with insurance policies and other contracts, the Company has outstanding standby letters of credit totaling \$3,817 as of June 30, 2018.

The Company is subject to ordinary litigation and routine reviews by regulatory bodies that are incidental to its business, none of which is expected to have a material adverse effect on the Company's financial condition, results of operations, or cash flows on an individual basis or in the aggregate.

Table of Contents

## 6. Accumulated other comprehensive loss

Accumulated other comprehensive loss (“AOCL”) consists of changes in our foreign currency forward contracts, pension liability adjustment, and foreign currency translation. The components of AOCL, net of tax, are shown below for the thirteen weeks ended June 30, 2018:

|  | Foreign<br>currency<br>hedge<br>instruments | Pension<br>liability<br>adjustment | Foreign<br>currency<br>translation | Total       |
|--|---|------------------------------------|------------------------------------|-------------|
| Balance at March 31, 2018  | \$ (102)                                    | \$ (1,793)                         | \$ (15,421)                        | \$ (17,316) |
| Other comprehensive (loss) income before reclassifications, net of tax | (1,356)                                     | 153                                | (5,291)                            | (6,494)     |
| Amounts reclassified to earnings, net of tax                           | (429)                                       | —                                  | —                                  | (429)       |
| Net current period other comprehensive loss                            | (1,785)                                     | 153                                | (5,291)                            | (6,923)     |
| Balance at June 30, 2018   | \$ (1,887)                                  | \$ (1,640)                         | \$ (20,712)                        | \$ (24,239) |

Amounts reclassified from AOCL to earnings for the foreign currency forward contracts category are generally included in cost of sales in the Company’s consolidated statements of operations. For a description of the Company’s use of foreign currency forward contracts, refer to Note 7.

## 7. Foreign currency forward contracts

The Company’s international operations and purchases of inventory products from foreign suppliers are subject to certain opportunities and risks, including foreign currency fluctuations. In the TCS segment, we utilize foreign currency forward contracts in Swedish krona to stabilize our retail gross margins and to protect our domestic operations from downward currency exposure by hedging purchases of inventory from our wholly-owned subsidiary, Elfa. Forward contracts in the TCS segment are designated as cash flow hedges, as defined by ASC 815. In the Elfa segment, we utilize foreign currency forward contracts to hedge purchases, primarily of raw materials, that are transacted in currencies other than Swedish krona, which is the functional currency of Elfa. Forward contracts in the Elfa segment are economic hedges and are not designated as cash flow hedges as defined by ASC 815.

During the thirteen weeks ended June 30, 2018 and July 1, 2017, the TCS segment used forward contracts for 100% and 100% of inventory purchases in Swedish krona, respectively. During the thirteen weeks ended June 30, 2018 and July 1, 2017, the Elfa segment used forward contracts to purchase U.S. dollars in the amount of zero and \$1,200,

which represented zero and 72% of the Elfa segment's U.S. dollar purchases, respectively. Generally, the Company's foreign currency forward contracts have terms from 10 to 12 months and require the Company to exchange currencies at agreed-upon rates at settlement.

The counterparties to the contracts consist of a limited number of major domestic and international financial institutions. The Company does not hold or enter into financial instruments for trading or speculative purposes. The Company records its foreign currency forward contracts on a gross basis and generally does not require collateral from these counterparties because it does not expect any losses from credit exposure.

The Company records all foreign currency forward contracts on its consolidated balance sheet at fair value. The Company accounts for its foreign currency hedging instruments in the TCS segment as cash flow hedges, as defined. Changes in the fair value of the foreign currency hedging instruments that are considered to be effective, as defined, are recorded in other comprehensive income (loss) until the hedged item (inventory) is sold to the customer, at which time the deferred gain or loss is recognized through cost of sales. Any portion of a change in the foreign currency hedge instrument's fair value that is considered to be ineffective, as defined, or that the Company has elected to exclude from its measurement of effectiveness, is immediately recorded in earnings as cost of sales. The Company assessed the effectiveness of the foreign currency hedge instruments and determined the foreign currency hedge instruments were highly effective during the thirteen weeks ended June 30, 2018 and July 1, 2017. Forward contracts not designated as

Table of Contents

hedges in the Elfa segment are adjusted to fair value as selling, general, and administrative expenses on the consolidated statements of operations; however, during the thirteen weeks ended June 30, 2018, the Company did not recognize any amount associated with the change in fair value of forward contracts not designated as hedging instruments, as the Company had none of these instruments outstanding.

The Company had a \$1,887 loss in accumulated other comprehensive loss related to foreign currency hedge instruments at June 30, 2018, of which \$415 represents an unrealized loss for settled foreign currency hedge instruments related to inventory on hand as of June 30, 2018. The Company expects the unrealized loss of \$415, net of taxes, to be reclassified into earnings over the next 12 months as the underlying inventory is sold to the end customer.

The change in fair value of the Company's foreign currency hedge instruments that qualify as cash flow hedges and are included in accumulated other comprehensive loss, net of taxes, are presented in Note 6 of these financial statements.

8. Fair value measurements

Under GAAP, the Company is required to a) measure certain assets and liabilities at fair value or b) disclose the fair values of certain assets and liabilities recorded at cost. Accounting standards define fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date. Fair value is calculated assuming the transaction occurs in the principal or most advantageous market for the asset or liability and includes consideration of non-performance risk and credit risk of both parties. Accounting standards pertaining to fair value establish a three-tier fair value hierarchy that prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1—Valuation inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.
- Level 2—Valuation inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Valuation inputs are unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are determined using model-based techniques that include option pricing models, discounted cash flow models and similar techniques.

As of June 30, 2018, March 31, 2018 and July 1, 2017, the Company held certain items that are required to be measured at fair value on a recurring basis. These included the nonqualified retirement plan and foreign currency



forward contracts. The nonqualified retirement plan consists of investments purchased by employee contributions to retirement savings accounts. The Company's foreign currency hedging instruments consist of over-the-counter (OTC) contracts, which are not traded on a public exchange. See Note 7 for further information on the Company's hedging activities.

The fair values of the nonqualified retirement plan and foreign currency forward contracts are determined based on the market approach which utilizes inputs that are readily available in public markets or can be derived from information available in publicly quoted markets for comparable assets. Therefore, the Company has categorized these items as Level 2. The Company also considers counterparty credit risk and its own credit risk in its determination of all estimated fair values. The Company has consistently applied these valuation techniques in all periods presented and believes it has obtained the most accurate information available for the types of contracts it holds.

Table of Contents

The following items are measured at fair value on a recurring basis, subject to the disclosure requirements of ASC 820, Fair Value Measurements:

| Description                        |         | Balance Sheet Location | June 30,<br>2018 | March 31,<br>2018 | July 1,<br>2017 |
|------------------------------------|---------|------------------------|------------------|-------------------|-----------------|
| Assets                             |         |                        |                  |                   |                 |
| Nonqualified retirement plan (1)   | N/A     | Other current assets   | \$ 5,999         | \$ 5,848          | \$ 5,138        |
| Foreign currency forward contracts | Level 2 | Other current assets   | —                | —                 | 2,434           |
| Total assets                       |         |                        | \$ 5,999         | \$ 5,848          | \$ 7,572        |

(1) The fair value amount of the nonqualified retirement plan is measured at fair value using the net asset value per share practical expedient, and therefore, is not classified in the fair value hierarchy.

The fair value of long-term debt was estimated using quoted prices as well as recent transactions for similar types of borrowing arrangements (Level 2 valuations). As of June 30, 2018, March 31, 2018 and July 1, 2017, the estimated fair value of the Company's long-term debt, including current maturities, was \$312,876, \$295,605, and \$315,359, respectively.

## 9. Segment reporting

The Company's reportable segments were determined on the same basis as how management evaluates performance internally by the Chief Operating Decision Maker ("CODM"). The Company has determined that the Chief Executive Officer is the CODM and the Company's two reportable segments consist of TCS and Elfa. The TCS segment includes the Company's retail stores, website and call center, as well as the installation and organization services business.

The Elfa segment includes the manufacturing business that produces the elfa® brand products that are sold domestically exclusively through the TCS segment, as well as on a wholesale basis in approximately 30 countries around the world with a concentration in the Nordic region of Europe. The intersegment sales in the Elfa column represent elfa® product sales to the TCS segment. These sales and the related gross margin on merchandise recorded in TCS inventory balances at the end of the period are eliminated for consolidation purposes in the Eliminations column. The net sales to third parties in the Elfa column represent sales to customers outside of the United States.

The Company has determined that adjusted earnings before interest, tax, depreciation, and amortization ("Adjusted EBITDA") is the profit or loss measure that the CODM uses to make resource allocation decisions and evaluate segment performance.

Adjusted EBITDA assists management in comparing our performance on a consistent basis for purposes of business decision-making by removing the impact of certain items that management believes do not directly reflect our core operations and, therefore, are not included in measuring segment performance. Adjusted EBITDA is calculated in accordance with the Senior Secured Term Loan Facility and the Revolving Credit Facility and we define Adjusted

15

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Table of Contents

EBITDA as net income before interest, taxes, depreciation and amortization, certain non cash items, and other adjustments that we do not consider in our evaluation of ongoing operating performance from period to period.

| Fiscal thirteen weeks ended June 30, 2018 | TCS        | Elfa      | Eliminations | Total      |
|---|------------|-----------|--------------|------------|
| Net sales to third parties                | \$ 180,082 | \$ 15,741 | \$ —         | \$ 195,823 |
| Intersegment sales                        | —          | 10,395    | (10,395)     | —          |
| Adjusted EBITDA                           | 10,103     | 1,599     | 689          | 12,391     |
| Interest expense, net                     | 7,845      | 63        | —            | 7,908      |
| Assets (1)                                | 649,190    | 106,446   | (3,273)      | 752,363    |

| Fiscal thirteen weeks ended July 1, 2017 | TCS        | Elfa      | Eliminations | Total      |
|--|------------|-----------|--------------|------------|
| Net sales to third parties               | \$ 167,059 | \$ 16,009 | \$ —         | \$ 183,068 |
| Intersegment sales                       | —          | 9,044     | (9,044)      | —          |
| Adjusted EBITDA                          | 5,764      | 1,143     | (477)        | 6,430      |
| Interest expense, net                    | 4,157      | 68        | —            | 4,225      |
| Assets (1)                               | 660,095    | 113,495   | (3,349)      | 770,241    |

(1) Tangible assets in the Elfa column are located outside of the United States.

A reconciliation of loss before taxes to Adjusted EBITDA is set forth below:

|  | Thirteen Weeks Ended |                 |
|--|----------------------|-----------------|
|  | June 30,<br>2018     | July 1,<br>2017 |
| Loss before taxes                            | \$ (10,244)          | \$ (12,262)     |
| Add:   |                      |                 |
| Depreciation and amortization                | 9,337                | 9,542           |
| Interest expense, net                        | 7,908                | 4,225           |
| Pre-opening costs (a)                        | 346                  | 1,386           |
| Non-cash rent (b)                            | (637)                | (461)           |
| Stock-based compensation (c)                 | 586                  | 494             |
| Foreign exchange losses (gains) (d)          | 38                   | (76)            |
| Optimization Plan implementation charges (e) | 4,864                | 3,534           |
| Other adjustments (f)                        | 193                  | 48              |
| Total Adjusted EBITDA                        | \$ 12,391            | \$ 6,430        |

(a) Non-capital expenditures associated with opening new stores and relocating stores, including rent, marketing expenses, travel and relocation costs, and training costs. We adjust for these costs to facilitate comparisons of our

performance from period to period.

- (b) Reflects the extent to which our annual GAAP rent expense has been above or below our cash rent payment due to lease accounting adjustments. The adjustment varies depending on the average age of our lease portfolio (weighted for size), as our GAAP rent expense on younger leases typically exceeds our cash cost, while our GAAP rent expense on older leases is typically less than our cash cost.
- (c) Non-cash charges related to stock-based compensation programs, which vary from period to period depending on volume and vesting timing of awards. We adjust for these charges to facilitate comparisons from period to period.
- (d) Realized foreign exchange transactional gains/losses our management does not consider in our evaluation of our ongoing operations.
- (e) Charges incurred to implement our Optimization Plan, which include certain consulting costs recorded in selling, general and administrative expenses in the first quarter of fiscal 2018, cash severance payments associated with the

Table of Contents

elimination of certain full-time positions at the TCS segment recorded in other expenses in the first quarter of fiscal 2017, and cash severance payments associated with organizational realignment at the Elfa segment recorded in other expenses in the first quarter of fiscal 2017, which we do not consider in our evaluation of ongoing performance.

- (f) Other adjustments include amounts our management does not consider in our evaluation of our ongoing operations, including certain severance and other charges.

10. Stock-based compensation

On June 1, 2018, the Company granted time-based and performance-based restricted stock awards under the Company's Amended and Restated 2013 Incentive Award Plan to certain officers and employees of the Company. The total number of restricted shares granted was 551,453 with a grant-date fair value of \$7.68. The time-based restricted stock awards will vest over 3 years. The performance-based restricted stock awards vest based on achievement of fiscal 2018 performance targets and are also subject to time-based vesting requirements over 3 years.

Unrecognized compensation expense related to outstanding restricted stock awards to employees as of June 30, 2018 is expected to be \$3,543 to be recognized over a weighted average period of 1.9 years. As of June 30, 2018, the total number of nonvested restricted stock awards was 701,106.

Table of Contents

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

Cautionary note regarding forward-looking statements

This report, including this Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "target," "projects," "contemplates," "believes," "estimates," "predicts," "potential" or "contingent," and the negative of these terms or other similar expressions. The forward-looking statements included in this Quarterly Report, including without limitation statements regarding expectations for our business, anticipated financial performance and liquidity, and expectations regarding our Optimization Plan, are only predictions and involve known and unknown risks, uncertainties and other important factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. These include, but are not limited to: a decline in the health of the economy and the purchase of discretionary items; risks related to new store openings; our inability to source and market our products to meet customer preferences or inability to offer customers an aesthetically pleasing shopping environment; the risk that our operating and financial performance in a given period will not meet the guidance we provided to the public; the risk that significant business initiatives may not be successful; our dependence on a single distribution center for all of our stores; risks related to opening a second distribution center; our reliance on third-party web service providers; the vulnerability of our facilities and systems to natural disasters and other unexpected events; risks related to our reliance on independent third-party transportation providers for substantially all of our product shipments; our dependence on our brand image and any inability to protect our brand; our failure to successfully anticipate consumer demand and manage inventory commensurate with demand; our failure to effectively manage our growth; our inability to lease space on favorable terms; fluctuations in currency exchange rates; risks related to a security breach or cyber-attack of our website or information technology systems, and other damage to such systems; our inability to effectively manage online sales; effects of competition on our business; risks related to our inability to obtain capital on satisfactory terms or at all; disruptions in the global financial markets leading to difficulty in borrowing sufficient amounts of capital to finance the carrying costs of inventory to pay for capital expenditures and operating costs; our inability to obtain merchandise from our vendors on a timely basis and at competitive prices; the risk that our vendors may sell their products to our competitors; our dependence on key executive management, and the transition in our executive leadership; our inability to find, train and retain key personnel; labor activities and unrest; rising health care and labor costs; risks associated with our dependence on foreign imports; risks related to violations of anti-bribery and anti-kickback laws; risks related to our indebtedness; risks related to our fixed lease obligations; material damage to or interruptions in our information technology systems; risks related to litigation; product recalls and/or product liability and changes in product safety and consumer protection laws; changes in statutory, regulatory, accounting and other legal requirements; risks related to changes in estimates or projections used to assess the fair value of our intangible assets; impacts to our business as a result of the Tax Cuts and Jobs Act; seasonal fluctuations in our operating results; material disruptions in one of our Elfa manufacturing facilities; our inability to protect our intellectual property rights and claims that we have infringed third parties' intellectual property rights; risks related to our status as a controlled company; significant fluctuations in the price of our common stock; substantial future sales of our common stock, or the perception that such sales may occur, which could depress the price of our common stock; risks related to being a public company; anti-takeover provisions in our governing documents, which could delay or prevent a change in control; reduced disclosure requirements applicable to emerging growth companies, which could make our stock less attractive to investors; and our failure to establish and maintain effective internal controls. Other important risk factors

that could affect the outcome of the events set forth in these statements and that could affect our operating results and financial condition are described in the “Risk Factors” section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the Securities and Exchange Commission (the “SEC”) on May 31, 2018.

We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. These forward-looking statements speak only as of the date of this report. Because forward-looking statements are inherently subject to risks and uncertainties, you should not rely on these forward-looking statements as predictions of future



## Table of Contents

events. Except as required by applicable law, we do not plan to publicly update or revise any forward-looking statements contained herein after the date of this report, whether as a result of any new information, future events or otherwise.

Unless the context otherwise requires, references in this Quarterly Report on Form 10-Q to the “Company,” “we,” “us,” and “our” refer to The Container Store Group, Inc. and, where appropriate, its subsidiaries.

We follow a 4-4-5 fiscal calendar, whereby each fiscal quarter consists of thirteen weeks grouped into two four-week “months” and one five-week “month”, and our fiscal year is the 52- or 53-week period ending on the Saturday closest to March 31. Fiscal 2018 ends on March 30, 2019 and fiscal 2017 ended on March 31, 2018. The first quarter of fiscal 2018 ended on June 30, 2018 and the first quarter of fiscal 2017 ended on July 1, 2017, and both included thirteen weeks.

## Overview

The Container Store® is the original and leading specialty retailer of storage and organization products and solutions in the United States and the only national retailer solely devoted to the category. We provide a collection of creative, multifunctional and customizable storage and organization solutions that are sold in our stores and online through a high-service, differentiated shopping experience. Our vision is to be a beloved brand and the first choice for customized organization solutions and services. Our customers are highly educated, very busy and primarily homeowners with a higher than average household income. We service them with storage and organization solutions that help them accomplish projects, maximize their space, and make the most of their home. We believe an organized life is a happy life.

Our operations consist of two operating segments:

The Container Store (“TCS”), which consists of our retail stores, website and call center, as well as our installation and organizational services business. As of June 30, 2018, we operated 91 stores with an average size of approximately 25,000 square feet (19,000 selling square feet) in 32 states and the District of Columbia. We allow our customers to shop with us in a variety of ways—anywhere, anytime, any way they want through a multi-channel shopping experience. Our stores receive substantially all of our products directly from our distribution center co-located with our corporate headquarters and call center in Coppell, Texas.

Elfa, The Container Store, Inc.’s wholly-owned Swedish subsidiary, Elfa International AB (“Elfa”), which designs and manufactures component-based shelving and drawer systems and made-to-measure sliding doors. Elfa was founded in

1948 and is headquartered in Malmö, Sweden. Elfa's shelving and drawer systems are customizable for any area of the home, including closets, kitchens, offices and garages. Elfa operates three manufacturing facilities with two located in Sweden and one in Poland. The Container Store began selling elfa® products in 1978 and acquired Elfa in 1999. Today our TCS segment is the exclusive distributor of elfa® products in the U.S. Elfa also sells its products on a wholesale basis to various retailers in approximately 30 countries around the world, with a concentration in the Nordic region of Europe.

#### Optimization Plan

As previously announced in fiscal 2017, the Company launched a four-part optimization plan to drive improved sales and profitability (the "Optimization Plan"). This plan includes sales initiatives, certain full-time position eliminations at TCS, organizational realignment at Elfa and ongoing savings and efficiency efforts.

In fiscal 2018, the Company expects to complete the Optimization Plan through the execution of a price optimization initiative. The price optimization initiative is designed to maximize sales and gross profit. The Company incurred approximately \$4.9 million of pre-tax charges associated with the implementation of the price optimization initiative in the first quarter of fiscal 2018 and does not currently expect to incur additional costs for the Optimization Plan in the remainder of fiscal 2018.

Table of Contents

## Note on Dollar Amounts

All dollar amounts in this Management's Discussion and Analysis of Financial Condition and Results of Operations are in thousands, except per share amounts and unless otherwise stated.

## Results of Operations

The following data represents the amounts shown in our unaudited consolidated statements of operations expressed in dollars and as a percentage of net sales and operating data for the periods presented. For segment data, see Note 9 to our unaudited consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

|   | Thirteen Weeks Ended |                 |
|---|----------------------|-----------------|
|   | June 30,<br>2018     | July 1,<br>2017 |
| Net sales   | \$ 195,823           | \$ 183,068      |
| Cost of sales (excluding depreciation and amortization)                                 | 81,052               | 79,458          |
| Gross profit  | 114,771              | 103,610         |
| Selling, general, and administrative expenses (excluding depreciation and amortization) | 106,605              | 96,640          |
| Stock based compensation  | 586                  | 494             |
| Pre-opening costs   | 346                  | 1,386           |
| Depreciation and amortization   | 9,337                | 9,542           |
| Other expenses  | 193                  | 3,534           |
| Loss on disposal of assets  | 40                   | 51              |
| Loss from operations  | (2,336)              | (8,037)         |
| Interest expense  | 7,908                | 4,225           |
| Loss before taxes   | (10,244)             | (12,262)        |
| Benefit for income taxes  | (3,480)              | (4,585)         |
| Net loss  | \$ (6,764)           | \$ (7,677)      |

Table of Contents

|   | Thirteen Weeks Ended |   |            |   |
|---|----------------------|---|------------|---|
|   | June 30,             |   | July 1,    |   |
|   | 2018                 |   | 2017       |   |
| Percentage of net sales:  |                      |   |            |   |
| Net sales   | 100.0                | % | 100.0      | % |
| Cost of sales (excluding depreciation and amortization)                                 | 41.4                 | % | 43.4       | % |
| Gross profit  | 58.6                 | % | 56.6       | % |
| Selling, general, and administrative expenses (excluding depreciation and amortization) | 54.4                 | % | 52.8       | % |
| Stock based compensation  | 0.3                  | % | 0.3        | % |
| Pre opening costs   | 0.2                  | % | 0.8        | % |
| Depreciation and amortization   | 4.8                  | % | 5.2        | % |
| Other expenses  | 0.1                  | % | 1.9        | % |
| Loss on disposal of assets  | 0.0                  | % | 0.0        | % |
| Loss from operations  | (1.2)                | % | (4.4)      | % |
| Interest expense  | 4.0                  | % | 2.3        | % |
| Loss before taxes   | (5.2)                | % | (6.7)      | % |
| Benefit for income taxes  | (1.8)                | % | (2.5)      | % |
| Net loss  | (3.5)                | % | (4.2)      | % |
| Operating data:   |                      |   |            |   |
| Comparable store sales growth for the period (1)  | 4.7                  | % | (1.2)      | % |
| Number of stores open at end of period  | 91                   |   | 87         |   |
| Non GAAP measures (2):  |                      |   |            |   |
| Adjusted EBITDA (3)   | \$ 12,391            |   | \$ 6,430   |   |
| Adjusted net loss (4)   | \$ (4,012)           |   | \$ (5,474) |   |
| Adjusted net loss per common share—diluted (4)  | \$ (0.08)            |   | \$ (0.11)  |   |

(1) A store is included in the comparable store sales calculation on the first day of the sixteenth full fiscal month following the store's opening. Comparable store sales reflect the point at which merchandise and service orders are fulfilled and delivered to customers, excluding shipping and delivery, and are net of discounts and returns. When a store is relocated, we continue to consider net sales from that store to be comparable store sales. Website, call center and business-to-business net sales are also included in calculations of comparable store sales.

(2) We have presented EBITDA, Adjusted EBITDA, adjusted net loss, and adjusted net loss per diluted share as supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. These non-GAAP measures should not be considered as alternatives to net loss as a measure of financial performance or cash flows from operations as a measure of liquidity, or any other performance measure derived in accordance with GAAP and they should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items. These non-GAAP measures are key metrics used by management, our board of directors, and LGP to assess our financial performance. We present these non-GAAP measures because we believe they assist investors in comparing our performance across reporting periods on a consistent basis by excluding items that we do not believe are indicative of our core operating performance and because we believe it is useful for investors to see the measures that management uses to evaluate the Company. These non-GAAP measures are also frequently used by analysts, investors and other interested parties to evaluate companies in our industry. In evaluating these non-GAAP measures, you should be aware that in the future we will incur expenses that are the

same as or similar to some of the adjustments in this presentation. Our presentation of these non-GAAP measures should not be construed to imply that our future results will be unaffected by any such adjustments. Management compensates for these limitations by relying on our GAAP results in addition to using non-GAAP measures supplementally. Our non-GAAP measures are not necessarily comparable to other similarly titled captions of other companies due to different methods of calculation. Please refer to footnotes (3) and (4) of this table for further information regarding why we believe each non-GAAP measure provides useful information to investors regarding our financial condition and results of operations, as well as the additional purposes for which management uses each non-GAAP financial measure.

Additionally, this Management's Discussion and Analysis also refers to Elfa third-party net sales after the conversion of Elfa's net sales from Swedish krona to U.S. dollars using the prior year's conversion rate. The

Table of Contents

Company believes the disclosure of Elfa third-party net sales without the effects of currency exchange rate fluctuations helps investors understand the Company's underlying performance.

(3) EBITDA and Adjusted EBITDA have been presented in this Quarterly Report on Form 10-Q as supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. We define EBITDA as net income before interest, taxes, depreciation, and amortization. Adjusted EBITDA is calculated in accordance with our Secured Term Loan Facility and the Revolving Credit Facility and is one of the components for performance evaluation under our executive compensation programs. Adjusted EBITDA reflects further adjustments to EBITDA to eliminate the impact of certain items, including certain non-cash and other items that we do not consider in our evaluation of ongoing operating performance from period to period as discussed further below.

EBITDA and Adjusted EBITDA, are included in this Quarterly Report on Form 10-Q because they are key metrics used by management, our board of directors and LGP to assess our financial performance. In addition, we use Adjusted EBITDA in connection with covenant compliance and executive performance evaluations, and we use Adjusted EBITDA to supplement GAAP measures of performance to evaluate the effectiveness of our business strategies, to make budgeting decisions and to compare our performance against that of other peer companies using similar measures. We believe it is useful for investors to see the measures that management uses to evaluate the Company, its executives and our covenant compliance, as applicable. EBITDA and Adjusted EBITDA are also frequently used by analysts, investors and other interested parties to evaluate companies in our industry.

EBITDA and Adjusted EBITDA are not GAAP measures of our financial performance or liquidity and should not be considered as alternatives to net income (loss) as a measure of financial performance or cash flows from operations as a measure of liquidity, or any other performance measure derived in accordance with GAAP and they should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items. Additionally, EBITDA and Adjusted EBITDA are not intended to be measures of free cash flow for management's discretionary use, as they do not reflect certain cash requirements such as tax payments, debt service requirements, capital expenditures, store openings and certain other cash costs that may recur in the future. EBITDA and Adjusted EBITDA contain certain other limitations, including the failure to reflect our cash expenditures, cash requirements for working capital needs and cash costs to replace assets being depreciated and amortized. In evaluating Adjusted EBITDA, you should be aware that in the future we will incur expenses that are the same as or similar to some of the adjustments in this presentation, such as pre-opening costs and stock compensation expense. Our presentation of Adjusted EBITDA should not be construed to imply that our future results will be unaffected by any such adjustments. Management compensates for these limitations by relying on our GAAP results in addition to using EBITDA and Adjusted EBITDA supplementally. Our measures of EBITDA and Adjusted EBITDA margin are not necessarily comparable to other similarly titled captions of other companies due to different methods of calculation.

A reconciliation of net loss to EBITDA and Adjusted EBITDA is set forth below:

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|  | Thirteen Weeks Ended |                 |
|--|----------------------|-----------------|
|  | June 30,<br>2018     | July 1,<br>2017 |
| Net loss                                     | \$ (6,764)           | \$ (7,677)      |
| Depreciation and amortization                | 9,337                | 9,542           |
| Interest expense, net                        | 7,908                | 4,225           |
| Income tax benefit                           | (3,480)              | (4,585)         |
| EBITDA                                       | 7,001                | 1,505           |
| Pre-opening costs (a)                        | 346                  | 1,386           |
| Non-cash rent (b)                            | (637)                | (461)           |
| Stock-based compensation (c)                 | 586                  | 494             |
| Foreign exchange losses (gains) (d)          | 38                   | (76)            |
| Optimization Plan implementation charges (e) | 4,864                | 3,534           |
| Other adjustments (f)                        | 193                  | 48              |
| Adjusted EBITDA                              | \$ 12,391            | \$ 6,430        |

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Table of Contents

- (a) Non-capital expenditures associated with opening new stores and relocating stores, including rent, marketing expenses, travel and relocation costs, and training costs. We adjust for these costs to facilitate comparisons of our performance from period to period.
  - (b) Reflects the extent to which our annual GAAP rent expense has been above or below our cash rent payment due to lease accounting adjustments. The adjustment varies depending on the average age of our lease portfolio (weighted for size), as our GAAP rent expense on younger leases typically exceeds our cash cost, while our GAAP rent expense on older leases is typically less than our cash cost.
  - (c) Non-cash charges related to stock-based compensation programs, which vary from period to period depending on volume and vesting timing of awards. We adjust for these charges to facilitate comparisons from period to period.
  - (d) Realized foreign exchange transactional gains/losses our management does not consider in our evaluation of our ongoing operations.
  - (e) Charges incurred to implement our Optimization Plan, which include certain consulting costs recorded in selling, general and administrative expenses in the first quarter of fiscal 2018, cash severance payments associated with the elimination of certain full-time positions at the TCS segment recorded in other expenses in the first quarter of fiscal 2017, and cash severance payments associated with organizational realignment at the Elfa segment recorded in other expenses in the first quarter of fiscal 2017, which we do not consider in our evaluation of ongoing performance.
  - (f) Other adjustments include amounts our management does not consider in our evaluation of our ongoing operations, including certain severance and other charges.
- (4) Adjusted net income (loss) and adjusted net income (loss) per diluted share have been presented in this Quarterly Report on Form 10-Q as supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. We define adjusted net income (loss) as net income (loss) before distributions accumulated to preferred shareholders, stock-based compensation and other costs in connection with our IPO, restructuring charges, impairment charges related to intangible assets, losses on extinguishment of debt, certain gains on disposal of assets, certain management transition costs incurred and benefits realized, charges incurred as part of the implementation of our Optimization Plan, charges associated with an Elfa manufacturing facility closure, and the tax impact of these adjustments and other unusual or infrequent tax items. We define adjusted net income (loss) per diluted share as adjusted net income (loss) divided by the diluted weighted average common shares outstanding. We use adjusted net income (loss) and adjusted net income (loss) per diluted share to supplement GAAP measures of performance to evaluate the effectiveness of our business strategies, to make budgeting decisions and to compare our performance against that of other peer companies using similar measures. We present adjusted net income (loss) and adjusted net income (loss) per diluted share because we believe they assist investors in comparing our performance across reporting periods on a consistent basis by excluding items that we do not believe are indicative of our core operating performance and because we believe it is useful for investors to see the measures that management uses to evaluate the Company.





Table of Contents

A reconciliation of the GAAP financial measures of net loss and net loss per diluted share to the non-GAAP financial measures of adjusted net loss and adjusted net loss per diluted share is set forth below:

|  | Thirteen Weeks Ended |                 |
|--|----------------------|-----------------|
|  | June 30,<br>2018     | July 1,<br>2017 |
| Numerator:   |                      |                 |
| Net loss   | \$ (6,764)           | \$ (7,677)      |
| Optimization Plan implementation charges (a)       | 4,864                | 3,534           |
| Taxes (b)  | (2,112)              | (1,331)         |
| Adjusted net loss                                  | \$ (4,012)           | \$ (5,474)      |
| Denominator:                                       |                      |                 |
| Weighted-average common shares outstanding-diluted | 48,138,907           | 48,047,937      |
| Adjusted net loss per common share-diluted         | \$ (0.08)            | \$ (0.11)       |

- (a) Charges incurred to implement our Optimization Plan, which includes certain consulting costs recorded in selling, general and administrative expenses in the first quarter of fiscal 2018, cash severance payments associated with the elimination of certain full-time positions at the TCS segment recorded in other expenses in the first quarter of fiscal 2017, and cash severance payments associated with organizational realignment at the Elfa segment recorded in other expenses in the first quarter of fiscal 2017, which we do not consider in our evaluation of ongoing performance.
- (b) Tax impact of adjustments to net loss, as well as the estimated impact of the Tax Cuts and Jobs Act enacted in fiscal 2017 and the tax benefit recorded in the first quarter of fiscal 2018 as a result of a reduction in the Swedish tax rate, which are considered to be unusual or infrequent tax items, all of which we do not consider in our evaluation of ongoing performance.

#### Thirteen Weeks Ended June 30, 2018 Compared to Thirteen Weeks Ended July 1, 2017

##### Net sales

The following table summarizes our net sales for each of the thirteen weeks ended June 30, 2018 and July 1, 2017:

| June 30,<br>2018 | % total | July 1,<br>2017 | % total |
|------------------|---------|-----------------|---------|
|------------------|---------|-----------------|---------|

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|                            |            |       |   |            |       |   |
|----------------------------|------------|-------|---|------------|-------|---|
| TCS net sales              | \$ 180,082 | 92.0  | % | \$ 167,059 | 91.3  | % |
| Elfa third party net sales | 15,741     | 8.0   | % | 16,009     | 8.7   | % |
| Net sales                  | \$ 195,823 | 100.0 | % | \$ 183,068 | 100.0 | % |

Net sales in the thirteen weeks ended June 30, 2018 increased by \$12,755, or 6.9%, compared to the thirteen weeks ended July 1, 2017. This increase is comprised of the following components:

|   |            |
|---|------------|
|   | Net sales  |
| Net sales for the thirteen weeks ended July 1, 2017                           | \$ 183,068 |
| Incremental net sales increase (decrease) due to:                             |            |
| Comparable stores (including a \$3,628, or 26.2%, increase in online sales)   | 7,730      |
| New stores  | 5,279      |
| Elfa third party net sales (excluding impact of foreign currency translation) | (510)      |
| Impact of foreign currency translation on Elfa third party net sales          | 242        |
| Shipping and delivery   | 14         |
| Net sales for the thirteen weeks ended June 30, 2018                          | \$ 195,823 |

In the thirteen weeks ended June 30, 2018, comparable stores generated a \$7,730, or 4.7%, increase in net sales. Additionally, five new stores generated \$5,279 of incremental net sales, four of which were opened during fiscal 2017 and one of which was opened in the first thirteen weeks of fiscal 2018. Elfa third party net sales decreased \$268 in the

Table of Contents

thirteen weeks ended June 30, 2018. After converting Elfa's third party net sales from Swedish krona to U.S. dollars using the prior year's conversion rate for both the thirteen weeks ended June 30, 2018 and thirteen weeks ended July 1, 2017, Elfa third party net sales decreased \$510 primarily due to lower net sales in emerging markets and the Nordic market.

## Gross profit and gross margin

Gross profit in the thirteen weeks ended June 30, 2018 increased by \$11,161, or 10.8%, compared to the thirteen weeks ended July 1, 2017. The increase in gross profit was primarily the result of increased consolidated net sales, combined with an increase in consolidated gross margin. The following table summarizes the gross margin for the thirteen weeks ended June 30, 2018 and July 1, 2017 by segment and total. The segment gross margins include the impact of inter-segment net sales from the Elfa segment to the TCS segment:

|                    | June 30, 2018 |   | July 1, 2017 |   |
|--------------------|---------------|---|--------------|---|
| TCS gross margin   | 57.9          | % | 56.5         | % |
| Elfa gross margin  | 37.3          | % | 39.0         | % |
| Total gross margin | 58.6          | % | 56.6         | % |

TCS gross margin increased 140 basis points primarily due to lower cost of goods associated with the Optimization Plan. Elfa gross margin decreased 170 basis points primarily due to higher direct materials costs during the quarter. In total, gross margin increased 200 basis points primarily due to increased sales of higher-margin elfa® products during the first quarter of fiscal 2018.

## Selling, general and administrative expenses

Selling, general and administrative expenses ("SG&A") in the thirteen weeks ended June 30, 2018 increased by \$9,965, or 10.3%, compared to the thirteen weeks ended July 1, 2017. As a percentage of consolidated net sales, SG&A increased by 160 basis points. The following table summarizes SG&A as a percentage of total net sales for the thirteen weeks ended June 30, 2018 and July 1, 2017:

|  | June 30, 2018  |   | July 1, 2017   |   |
|--|----------------|---|----------------|---|
|  | % of net sales |   | % of net sales |   |
| TCS selling, general and administrative  | 50.2           | % | 48.1           | % |
| Elfa selling, general and administrative | 4.2            | % | 4.7            | % |

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|   |      |   |      |   |
|---|------|---|------|---|
| Total selling, general and administrative | 54.4 | % | 52.8 | % |
|---|------|---|------|---|

TCS selling, general and administrative expenses increased by 210 basis points as a percentage of consolidated net sales. This was primarily due to consulting costs incurred as part of the implementation of the Optimization Plan, which contributed 240 basis points to the increase in the first quarter of fiscal 2018. This was partially offset by 30 basis points of improvement in SG&A expense as a percentage of net sales, primarily due to ongoing savings and efficiency efforts. Elfa selling, general and administrative expenses decreased by 50 basis points as a percentage of consolidated net sales, primarily due to ongoing savings and efficiency efforts.

Pre-opening costs

Pre-opening costs decreased by \$1,040, or 75.0%, in the thirteen weeks ended June 30, 2018 to \$346, as compared to \$1,386 in the thirteen weeks ended July 1, 2017. We opened one store in the thirteen weeks ended June 30, 2018, and we opened one store in the thirteen weeks ended July 1, 2017. The decrease in pre-opening costs is primarily due to the incurrence of certain pre-opening costs in the first quarter of fiscal 2017 for a store opening that opened early in the second quarter of fiscal 2017.

## Table of Contents

### Other expenses

Other expenses of \$193 were recorded in the thirteen weeks ended June 30, 2018, as compared to \$3,534 in the thirteen weeks ended July 1, 2017. The \$3,341 decrease in other expenses is primarily due to severance costs incurred in the first thirteen weeks of fiscal 2017 associated with the Optimization Plan.

### Interest expense

Interest expense increased by \$3,683, or 87%, in the thirteen weeks ended June 30, 2018 to \$7,908, as compared to \$4,225 in the thirteen weeks ended July 1, 2017. On August 18, 2017, the Company entered into a fourth amendment (the “Term Loan Amendment”) to the Senior Secured Term Loan Facility dated as of April 6, 2012. The fourth amendment amends the Senior Secured Term Loan Facility to, among other things, increase the applicable interest rate margin to 7.0% for LIBOR loans and 6.00% for base rate loans, which resulted in increased interest expense during the thirteen weeks ended June 30, 2018.

### Taxes

The benefit for income taxes in the thirteen weeks ended June 30, 2018 was \$3,480 as compared to a benefit of \$4,585, in the thirteen weeks ended July 1, 2017. The effective tax rate for the thirteen weeks ended June 30, 2018 was 34.0%, as compared to 37.4% in the thirteen weeks ended July 1, 2017. The decrease in the effective tax rate is primarily due to lower statutory rates as a result of the Tax Cuts and Jobs Act enacted in fiscal 2017, partially offset by a benefit for the remeasurement of deferred tax balances recorded in the first quarter of fiscal 2018 as a result of a change in the Swedish tax rate.

### Liquidity and Capital Resources

We rely on cash flows from operations, a \$100,000 asset-based revolving credit agreement (the “Revolving Credit Facility” as further discussed under “Revolving Credit Facility” below), and the SEK 140.0 million (approximately \$15.6 million as of June 30, 2018) 2014 Elfa revolving credit facility (the “2014 Elfa Revolving Credit Facility” as further discussed under “2014 Elfa Senior Secured Credit Facilities” below) as our primary sources of liquidity. Our primary cash needs are for merchandise inventories, direct materials, payroll, store rent, capital expenditures associated with opening new stores and updating existing stores, as well as information technology and infrastructure, including our existing and future distribution centers and Elfa manufacturing facility enhancements. The most significant components of our operating assets and liabilities are merchandise inventories, accounts receivable, prepaid expenses and other assets, accounts payable, other current and non-current liabilities, taxes receivable and taxes payable. Our

liquidity fluctuates as a result of our building inventory for key selling periods, and as a result, our borrowings are generally higher during these periods when compared to the rest of our fiscal year. Our borrowings generally increase in our second and third fiscal quarters as we prepare for Our Annual Shelving Sale, the holiday season, and Our Annual elfa® Sale. We believe that cash expected to be generated from operations and the availability of borrowings under the Revolving Credit Facility and the 2014 Elfa Revolving Credit Facility will be sufficient to meet liquidity requirements, anticipated capital expenditures, and payments due under our existing credit facilities for at least the next 12 months. In the future, we may seek to raise additional capital, which could be in the form of loans, bonds, convertible debt or equity, to fund our operations and capital expenditures. There can be no assurance that we will be able to raise additional capital on favorable terms.

At June 30, 2018, we had \$14,102 of cash, of which \$3,766 was held by our foreign subsidiaries. In addition, we had \$55,857 of additional availability under the Revolving Credit Facility and approximately \$14,751 of additional availability under the 2014 Elfa Revolving Credit Facility as of June 30, 2018. There were \$3,817 in letters of credit outstanding under the Revolving Credit Facility and other contracts at that date.

Pursuant to the Tax Act, we will be required to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred. The Company recorded a provisional amount of \$8,521 for the one-time transition tax in fiscal 2017, which is required to be paid in installments over 8 years. Future amounts earned in our foreign subsidiaries are not expected to be subject to federal income taxes upon transfer to the United States. However, if these

Table of Contents

funds were transferred to the United States, we may be required to pay taxes in certain international jurisdictions as well as certain states. It is our intent to indefinitely reinvest these funds outside the United States.

Cash flow analysis

A summary of our operating, investing and financing activities are shown in the following table:

|   | Thirteen Weeks Ended |            |
|---|----------------------|------------|
|   | June 30,             | July 1,    |
|   | 2018                 | 2017       |
| Net cash used in operating activities     | \$ (3,320)           | \$ (4,781) |
| Net cash used in investing activities     | (4,455)              | (5,179)    |
| Net cash provided by financing activities | 13,842               | 6,226      |
| Effect of exchange rate changes on cash   | (364)                | 214        |
| Net increase (decrease) in cash           | \$ 5,703             | \$ (3,520) |
| Free cash flow (Non-GAAP)(1)              | \$ (7,776)           | \$ (9,962) |

(1) See below for a discussion of this non-GAAP financial measure and reconciliation to its most directly comparable GAAP financial measure

Net cash used in operating activities

Cash from operating activities consists primarily of net income adjusted for non-cash items, including depreciation and amortization, deferred taxes and the effect of changes in operating assets and liabilities.

Net cash used in operating activities was \$3,320 for the thirteen weeks ended June 30, 2018. Net loss of \$6,764 and a net change in operating assets and liabilities of 3,404 were partially offset by non-cash items of \$6,848. The net change in operating assets and liabilities is primarily due to an increase in merchandise inventory and a decrease in income taxes payable, partially offset by a decrease in accounts payable and accrued liabilities during the thirteen weeks ended June 30, 2018.

Net cash used in operating activities was \$4,781 for the thirteen weeks ended July 1, 2017. A net loss of \$7,677 and a net change in operating assets and liabilities of \$3,293 were partially offset by non-cash items of \$6,189. The net



change in operating assets and liabilities is primarily due to an increase in prepaid expenses and other assets primarily due to a shift in the timing of rent payments and a decrease in income taxes payable due to an income tax payment that was made in the first fiscal quarter of 2017, partially offset by an increase in accounts payable and accrued liabilities during the thirteen weeks ended July 1, 2017.

Net cash used in investing activities

Investing activities consist primarily of capital expenditures for new store openings, existing store remodels, infrastructure, information systems, and our distribution center.

Our total capital expenditures for the thirteen weeks ended June 30, 2018 were \$4,456 with new store openings, relocations and existing store remodels accounting for more than half of spending at \$2,388. We opened one store during the thirteen weeks ended June 30, 2018. The remaining capital expenditures of \$2,068 were primarily for investments in our distribution center and information technology.

Our total capital expenditures for the thirteen weeks ended July 1, 2017 were \$5,181 with new store openings and existing store remodels accounting for more than half of spending at \$3,155. We opened one new store during the thirteen weeks ended July 1, 2017. The remaining capital expenditures of \$2,026 were primarily for investments in our distribution center and information technology.

Table of Contents

Net cash provided by financing activities

Financing activities consist primarily of borrowings and payments under the Senior Secured Term Loan Facility, the Revolving Credit Facility, and the Elfa Revolving Credit Facility.

Net cash provided by financing activities was \$13,842 for the thirteen weeks ended June 30, 2018. This included proceeds of \$15,000 from borrowings under the Revolving Credit Facility combined with net proceeds of \$918 from borrowings under the 2014 Elfa Revolving Credit Facility to support higher working capital needs. The net proceeds of the revolver borrowings were partially offset by payments of \$1,954 for repayment of long-term indebtedness and \$122 for taxes paid with the withholding of shares upon vesting of restricted stock awards.

Net cash provided by financing activities was \$6,226 for the thirteen weeks ended July 1, 2017. This included net proceeds of \$5,000 from borrowings under the Revolving Credit Facility combined with net proceeds of \$2,615 from borrowings under the 2014 Elfa Revolving Credit Facility to support higher working capital needs. The net proceeds of the revolver borrowings were partially offset by payments of \$1,350 for repayment of long-term indebtedness and \$39 for taxes paid with the withholding of shares upon vesting of restricted stock awards.

As of June 30, 2018, TCS had a total of \$55,857 of unused borrowing availability under the Revolving Credit Facility, and \$15,000 of borrowings outstanding under the Revolving Credit Facility.

As of June 30, 2018, Elfa had a total of \$14,751 of unused borrowing availability under the 2014 Elfa Revolving Credit Facility and \$889 borrowings outstanding under the 2014 Elfa Revolving Credit Facility.

Free cash flow (Non-GAAP)

The Company presents free cash flow, which the Company defines as net cash provided by (used in) operating activities in a period minus payments for property and equipment made in that period, because it believes it is a useful indicator of the Company's overall liquidity, as the amount of free cash flow generated in any period is representative of cash that is available for debt repayment, investment, and other discretionary and non-discretionary cash uses. Accordingly, we believe that free cash flow provides useful information to investors in understanding and evaluating our liquidity in the same manner as management. Our definition of free cash flow is limited in that it does not solely represent residual cash flows available for discretionary expenditures due to the fact that the measure does not deduct the payments required for debt service and other contractual obligations. Therefore, we believe it is important to view free cash flow as a measure that provides supplemental information to our Consolidated Statements of Cash Flows. Although other companies report their free cash flow, numerous methods may exist for calculating a company's free cash flow. As a result, the method used by our management to calculate our free cash flow may differ from the methods used by other companies to calculate their free cash flow.

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Our free cash flow fluctuates as a result of seasonality of net sales, building inventory for key selling periods, and timing of investments in new store openings, existing store remodels, infrastructure, information systems, and our distribution center, among other things. Historically, our free cash flow has been lower in the first fiscal quarter, due to lower net sales, operating income, and cash flows from operations, and as such, is not necessarily indicative of the free cash flow for the full year.

The following table sets forth a reconciliation of free cash flow, a non-GAAP financial measure, to net cash used in operating activities, which we believe to be the GAAP financial measure most directly comparable to free cash flow:

|   | Thirteen Weeks Ended |                 |
|---|----------------------|-----------------|
|   | June 30,<br>2018     | July 1,<br>2017 |
| Net cash used in operating activities     | \$ (3,320)           | \$ (4,781)      |
| Less: Additions to property and equipment | (4,456)              | (5,181)         |
| Free cash flow                            | \$ (7,776)           | \$ (9,962)      |

Table of Contents

Senior Secured Term Loan Facility

On April 6, 2012, The Container Store Group, Inc., The Container Store, Inc. and certain of its domestic subsidiaries entered into a credit agreement with JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, and the lenders party thereto (as amended, the “Senior Secured Term Loan Facility”).

The aggregate principal amount of the facility is \$300,000. Under the Senior Secured Term Loan Facility, we had \$292,500 in outstanding borrowings as of June 30, 2018 and the interest rate on such borrowings is LIBOR + 7.00%, subject to a LIBOR floor of 1.00%. The Senior Secured Term Loan Facility provides that we are required to make quarterly principal repayments of \$1,875 through June 30, 2021, with a balloon payment for the remaining balance due on August 18, 2021. The Senior Secured Term Loan Facility imposes a 1% premium if a voluntary prepayment is made from the proceeds of a repricing transaction within 12 months after August 18, 2017.

The Senior Secured Term Loan Facility is secured by (a) a first priority security interest in substantially all of our assets (excluding stock in foreign subsidiaries in excess of 65%, assets of non-guarantors and certain other exceptions) (other than the collateral that secures the Revolving Credit Facility described below on a first-priority basis) and (b) a second priority security interest in the assets securing the Revolving Credit Facility described below on a first-priority basis. Obligations under the Senior Secured Term Loan Facility are guaranteed by The Container Store Group, Inc. and each of The Container Store, Inc.’s U.S. subsidiaries. The Senior Secured Term Loan Facility contains a number of covenants that, among other things, restrict our ability, subject to specified exceptions, to incur additional debt; incur additional liens and contingent liabilities; sell or dispose of assets; merge with or acquire other companies; liquidate or dissolve ourselves, engage in businesses that are not in a related line of business; make loans, advances or guarantees; engage in transactions with affiliates; and make investments. In addition, the financing agreements contain certain cross-default provisions and also require certain mandatory prepayments of the Senior Secured Term Loan Facility, among these an Excess Cash Flow requirement (as such term is defined in the Senior Secured Term Loan Facility). As of June 30, 2018, we were in compliance with all covenants and no Event of Default (as such term is defined in the Senior Secured Term Loan Facility) had occurred.

Revolving Credit Facility

On April 6, 2012, The Container Store Group, Inc., The Container Store, Inc. and certain of its domestic subsidiaries entered into an asset-based revolving credit agreement with the lenders party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, and Wells Fargo Bank, National Association, as Syndication Agent (as amended, the "Revolving Credit Facility"). The maturity date of the loans under the Revolving Credit Facility is the earlier of (i) August 18, 2022 and (ii) May 18, 2021 if any portion of the Senior Secured Term Loan Facility remains outstanding on such date and the maturity date of the Senior Secured Term Loan Facility is not extended.

The aggregate principal amount of the facility is \$100,000. Borrowings under the Revolving Credit Facility accrue interest at LIBOR+1.25%. In addition, the Revolving Credit Facility includes an uncommitted incremental revolving facility in the amount of \$50,000, which is subject to receipt of lender commitments and satisfaction of specified conditions.

The Revolving Credit Facility provides that proceeds are to be used for working capital and other general corporate purposes, and allows for swing line advances of up to \$15,000 and the issuance of letters of credit of up to \$40,000.

The availability of credit at any given time under the Revolving Credit Facility is limited by reference to a borrowing base formula based upon numerous factors, including the value of eligible inventory, eligible accounts receivable, and reserves established by the administrative agent. As a result of the borrowing base formula, the actual borrowing availability under the Revolving Credit Facility could be less than the stated amount of the Revolving Credit Facility (as reduced by the actual borrowings and outstanding letters of credit under the Revolving Credit Facility).

Table of Contents

The Revolving Credit Facility is secured by (a) a first-priority security interest in substantially all of our personal property, consisting of inventory, accounts receivable, cash, deposit accounts, and other general intangibles, and (b) a second-priority security interest in the collateral that secures the Senior Secured Term Loan Facility on a first-priority basis, as described above (excluding stock in foreign subsidiaries in excess of 65%, and assets of non-guarantor subsidiaries and subject to certain other exceptions). Obligations under the Revolving Credit Facility are guaranteed by The Container Store Group, Inc. and each of The Container Store, Inc.'s U.S. subsidiaries.

The Revolving Credit Facility contains a number of covenants that, among other things, restrict our ability, subject to specified exceptions, to incur additional debt; incur additional liens and contingent liabilities; sell or dispose of assets; merge with or acquire other companies; liquidate or dissolve ourselves, engage in businesses that are not in a related line of business; make loans, advances or guarantees; engage in transactions with affiliates; and make investments. In addition, the financing agreements contain certain cross-default provisions. We are required to maintain a consolidated fixed-charge coverage ratio of 1.0 to 1.0 if excess availability is less than \$10,000 at any time. As of June 30, 2018, we were in compliance with all covenants and no Event of Default (as such term is defined in the Revolving Credit Facility) had occurred.

2014 Elfa Senior Secured Credit Facilities

On April 1, 2014, Elfa entered into a master credit agreement with Nordea Bank AB ("Nordea"), which consists of a SEK 60.0 million (approximately \$6,703 as of June 30, 2018) term loan facility (the "2014 Elfa Term Loan Facility") and a SEK 140.0 million (approximately \$15,640 as of June 30, 2018) revolving credit facility (the "2014 Elfa Revolving Credit Facility," and together with the 2014 Elfa Term Loan Facility, the "2014 Elfa Senior Secured Credit Facilities"). The 2014 Elfa Senior Secured Credit Facilities term began on August 29, 2014 and matures on August 29, 2019, or such shorter period as provided by the agreement. The remaining balance of the 2014 Elfa Term Loan Facility was paid on February 18, 2018, which was prior to the maturity date. Elfa was required to make quarterly principal payments under the 2014 Elfa Term Loan Facility in the amount of SEK 3.0 million (approximately \$335 as of June 30, 2018). The 2014 Elfa Revolving Credit Facility bears interest at Nordea's base rate + 1.4%. In the fourth quarter of fiscal 2016, Elfa and Nordea agreed that the stated rates would apply through maturity.

The 2014 Elfa Senior Secured Credit Facilities contain a number of covenants that, among other things, restrict Elfa's ability, subject to specified exceptions, to incur additional liens, sell or dispose of assets, merge with other companies, engage in businesses that are not in a related line of business and make guarantees. In addition, Elfa is required to maintain (i) a consolidated equity ratio (as defined in the 2014 Elfa Senior Secured Credit Facilities) of not less than 30% in year one and not less than 32.5% thereafter and (ii) a consolidated ratio of net debt to EBITDA (as defined in the 2014 Elfa Senior Secured Credit Facilities) of less than 3.2, the consolidated equity ratio tested at the end of each calendar quarter and the ratio of net debt to EBITDA tested as of the end of each fiscal quarter. As of June 30, 2018, Elfa was in compliance with all covenants and no Event of Default (as defined in the 2014 Elfa Senior Secured Credit Facilities) had occurred.

Critical accounting policies and estimates

The preparation of financial statements in accordance with generally accepted accounting principles in the United States requires management to make estimates and assumptions about future events that affect amounts reported in our consolidated financial statements and related notes, as well as the related disclosure of contingent assets and liabilities at the date of the financial statements. A summary of the Company's significant accounting policies is included in Note 1 to the Company's annual consolidated financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the SEC on May 31, 2018.

Certain of the Company's accounting policies and estimates are considered critical, as these policies and estimates are the most important to the depiction of the company's consolidated financial statements and require significant, difficult, or complex judgments, often about the effect of matters that are inherently uncertain. Such policies are summarized in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the SEC on May 31, 2018. As of June 30,

Table of Contents

2018, there were no significant changes to any of our critical accounting policies and estimates, with the exception of the adoption of ASU 2014-09, Revenue from Contracts with Customers, as discussed in Note 1 of our unaudited consolidated financial statements.

Contractual obligations

There have been no material changes to our contractual obligations as disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the SEC on May 31, 2018, other than those which occur in the normal course of business.

Off Balance Sheet Arrangements

We are not party to any off balance sheet arrangements.

Recent Accounting Pronouncements

Please refer to Note 1 of our unaudited consolidated financial statements for a summary of recent accounting pronouncements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risk profile as of June 30, 2018 has not materially changed since March 31, 2018. Our market risk profile as of March 31, 2018 is disclosed in our Annual Report on Form 10-K filed with the SEC on May 31, 2018. See Note 7 of Notes to our unaudited consolidated financial statements included in Part I, Item 1, of this Form 10-Q, for disclosures on our foreign currency forward contracts.

ITEM 4. CONTROLS AND PROCEDURES

Limitations on Effectiveness of Controls and Procedures



In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs.

#### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated, as of the end of the period covered by this Quarterly Report on Form 10-Q, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of June 30, 2018.

#### Changes in Internal Control

There were no changes in our internal control over financial reporting identified in management’s evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the quarter ended June 30, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to various legal proceedings and claims, including employment claims, wage and hour claims, intellectual property claims, contractual and commercial disputes and other matters that arise in the ordinary course of business. While the outcome of these and other claims cannot be predicted with certainty, management does not believe that the outcome of these matters will have a material adverse effect on our business, results of operations or financial condition on an individual basis or in the aggregate.

ITEM 1A. RISK FACTORS

There have been no material changes to our risk factors as previously disclosed in Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the SEC on May 31, 2018.

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

None.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

32

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Table of Contents

## ITEM 6. EXHIBITS

| Exhibit<br>Number | Exhibit Description   | Incorporated by Reference |           |         | Filing<br>Date | Filed/<br>Furnished<br>Herewith |
|-------------------|---|---------------------------|-----------|---------|----------------|---------------------------------|
|                   |   | Form                      | File No.  | Exhibit |                |                                 |
| 3.1               | <u>Amended and Restated Certificate of Incorporation of The Container Store Group, Inc.</u> | 10-Q                      | 001-36161 | 3.1     | 1/10/14        |                                 |
| 3.2               | <u>Amended and Restated By-laws of The Container Store Group, Inc.</u>                      | 10-Q                      | 001-36161 | 3.2     | 1/10/14        |                                 |
| 31.1              | <u>Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)</u>     |                           |           |         |                | *                               |
| 31.2              | <u>Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)</u>     |                           |           |         |                | *                               |
| 32.1              | <u>Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350</u>      |                           |           |         |                | **                              |
| 32.2              | <u>Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350</u>      |                           |           |         |                | **                              |
| 101.INS           | XBRL Instance Document  |                           |           |         |                | *                               |
| 101.SCH           | XBRL Taxonomy Extension Schema Document   |                           |           |         |                | *                               |
| 101.CAL           | XBRL Taxonomy Calculation Linkbase Document   |                           |           |         |                | *                               |
| 101.DEF           | XBRL Taxonomy Extension Definition Linkbase Document  |                           |           |         |                | *                               |
| 101.LAB           | XBRL Taxonomy Extension Label Linkbase Document   |                           |           |         |                | *                               |
| 101.PRE           | XBRL Taxonomy Extension Presentation  |                           |           |         |                | *                               |

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\* Filed herewith.

\*\* Furnished herewith.



Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

The Container Store Group, Inc.

(Registrant)

Date: August 2, 2018 /s/ Jodi L. Taylor  
Jodi L. Taylor  
Chief Financial Officer and Chief  
Administrative Officer (duly authorized  
officer and Principal Financial Officer)

Date: August 2, 2018 /s/ Jeffrey A. Miller  
Jeffrey A. Miller  
Chief Accounting Officer (Principal  
Accounting Officer)