

PRICESMART INC  
Form 10-Q  
April 09, 2014

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

FORM 10-Q

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

For the quarterly period ended February 28, 2014

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NUMBER 0-22793

PriceSmart, Inc.  
(Exact name of registrant as specified in its charter)  
Delaware  
(State or other jurisdiction of incorporation or organization)

33-0628530  
(I.R.S. Employer Identification No.)

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

(858) 404-8800  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Yes  No

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

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

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

Yes  No

The registrant had 30,205,589 shares of its common stock, par value \$0.0001 per share, outstanding at March 31, 2014.

PRICESMART, INC.

INDEX TO FORM 10-Q

	Page
<u>PART I - FINANCIAL INFORMATION</u>	
<u>ITEM 1. FINANCIAL STATEMENTS</u>	<u>1</u>
<u>CONSOLIDATED BALANCE SHEETS AS OF FEBRUARY 28, 2014 (UNAUDITED) AND AUGUST 31, 2013</u>	<u>2</u>
<u>CONSOLIDATED STATEMENTS OF INCOME FOR THE THREE AND SIX MONTHS ENDED FEBRUARY 28, 2014 AND 2013 - UNAUDITED</u>	<u>3</u>
<u>CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME FOR THE THREE AND SIX MONTHS ENDED FEBRUARY 28, 2014 AND 2013 - UNAUDITED</u>	<u>4</u>
<u>CONSOLIDATED STATEMENTS OF EQUITY FOR THE SIX MONTHS ENDED FEBRUARY 28, 2014 AND 2013 - UNAUDITED</u>	<u>5</u>
<u>CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE SIX MONTHS ENDED FEBRUARY 28, 2014 AND 2013 - UNAUDITED</u>	<u>6</u>
<u>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED</u>	<u>7</u>
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	<u>36</u>
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>60</u>
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	<u>65</u>
<u>PART II - OTHER INFORMATION</u>	
<u>ITEM 1. LEGAL PROCEEDINGS</u>	<u>66</u>
<u>ITEM 1A. RISK FACTORS</u>	<u>66</u>
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	<u>66</u>
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	<u>68</u>
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	<u>68</u>
<u>ITEM 5. OTHER INFORMATION</u>	<u>68</u>
<u>ITEM 6. EXHIBITS</u>	<u>69</u>



PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PriceSmart, Inc.'s ("PriceSmart" or the "Company") unaudited consolidated balance sheet as of February 28, 2014 and the consolidated balance sheet as of August 31, 2013, the unaudited consolidated statements of income for the three and six months ended February 28, 2014 and 2013, the unaudited consolidated statements of comprehensive income for the three and six months ended February 28, 2014 and 2013, the unaudited consolidated statements of equity for the six months ended February 28, 2014 and 2013, and the unaudited consolidated statements of cash flows for the six months ended February 28, 2014 and 2013, are included herein. Also included herein are the notes to the unaudited consolidated financial statements.

1

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

	February 28, 2014 (Unaudited)	August 31, 2013
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$75,337	\$121,874
Short-term restricted cash	2,328	5,984
Receivables, net of allowance for doubtful accounts of \$6 and \$0 as of February 28, 2014 and August 31, 2013, respectively	3,614	3,130
Merchandise inventories	236,471	217,413
Deferred tax assets – current	6,219	6,290
Prepaid expenses and other current assets (includes \$891 and \$0 as of February 28, 2014 and August 31, 2013, respectively, for the fair value of derivative instruments)	24,654	20,890
Total current assets	348,623	375,581
Long-term restricted cash	26,760	34,775
Property and equipment, net	374,335	338,478
Goodwill	36,321	36,364
Deferred tax assets – long term	12,942	12,871
Other non-current assets (includes \$1,969 and \$1,505 as of February 28, 2014 and August 31, 2013, respectively, for the fair value of derivative instruments)	26,477	19,866
Investment in unconsolidated affiliates	8,858	8,104
Total Assets	\$834,316	\$826,039
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities:		
Accounts payable	\$194,959	\$199,425
Accrued salaries and benefits	15,048	17,862
Deferred membership income	18,042	16,528
Income taxes payable	8,431	8,059
Other accrued expenses	18,115	20,136
Dividends payable	10,593	—
Long-term debt, current portion	18,887	12,757
Deferred tax liability – current	138	111
Total current liabilities	284,213	274,878
Deferred tax liability – long-term	3,107	2,622
Long-term portion of deferred rent	4,672	4,440
Long-term income taxes payable, net of current portion	1,978	2,184
Long-term debt, net of current portion	41,308	60,263
Other long-term liabilities (includes \$0 and \$14 for the fair value of derivative instruments and \$645 and \$589 for the defined benefit plans as of February 28, 2014 and August 31, 2013, respectively)		603
Total liabilities	335,923	344,990
Equity:		
Common stock, \$0.0001 par value, 45,000,000 shares authorized; 30,943,763 and 30,924,392 shares issued and 30,205,586 and 30,234,506 shares outstanding (net of 3 treasury shares) as of February 28, 2014 and August 31, 2013, respectively	3	3

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Preferred stock \$.0001 par value; 2,000,000 shares authorized; no shares issued and outstanding as of February 28, 2014 and August 31, 2013	—	—
Additional paid-in capital	394,020	390,581
Tax benefit from stock-based compensation	9,361	8,016
Accumulated other comprehensive loss	(52,914	) (41,475 )
Retained earnings	172,418	143,871
Less: treasury stock at cost; 738,177 and 689,886 shares as of February 28, 2014 and August 31, 2013, respectively	(24,495	) (19,947 )
Total equity	498,393	481,049
Total Liabilities and Equity	\$834,316	\$826,039
See accompanying notes.		

2

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

	Three Months Ended February 28,		Six Months Ended February 28,	
	2014	2013	2014	2013
Revenues:				
Net warehouse club sales	\$657,167	\$591,855	\$1,246,861	\$1,115,454
Export sales	6,764	6,323	12,485	9,396
Membership income	9,481	8,326	18,749	15,999
Other income	962	906	1,880	1,847
Total revenues	674,374	607,410	1,279,975	1,142,696
Operating expenses:				
Cost of goods sold:				
Net warehouse club	561,652	504,725	1,065,939	949,669
Export	6,423	5,986	11,864	8,821
Selling, general and administrative:				
Warehouse club operations	53,203	48,213	104,975	94,055
General and administrative	13,277	11,888	24,461	23,046
Pre-opening expenses	340	147	814	886
Loss/(gain) on disposal of assets	104	47	188	104
Total operating expenses	634,999	571,006	1,208,241	1,076,581
Operating income	39,375	36,404	71,734	66,115
Other income (expense):				
Interest income	193	446	374	740
Interest expense	(886)	(1,306)	(1,924)	(2,524)
Other income (expense), net	712	(265)	1,023	(264)
Total other expense	19	(1,125)	(527)	(2,048)
Income before provision for income taxes and income (loss) of unconsolidated affiliates	39,394	35,279	71,207	64,067
Provision for income taxes	(11,116)	(10,393)	(21,501)	(19,172)
Income (loss) of unconsolidated affiliates	—	(4)	4	(8)
Net income	\$28,278	\$24,882	\$49,710	\$44,887
Net income per share available for distribution:				
Basic net income per share	\$0.93	\$0.82	\$1.64	\$1.48
Diluted net income per share	\$0.93	\$0.82	\$1.64	\$1.48
Shares used in per share computations:				
Basic	29,724	29,626	29,707	29,609
Diluted	29,736	29,636	29,719	29,620
Dividends per share	\$0.70	\$—	\$0.70	\$0.60

See accompanying notes.

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

	Three Months Ended February 28,		Six Months Ended February 28,	
	2014	2013	2014	2013
Net income	\$28,278	\$24,882	\$49,710	\$44,887
Other Comprehensive Income, net of tax:				
Foreign currency translation adjustments <sup>(1)</sup>	\$(13,661 )	\$(1,614 )	\$(12,372 )	\$(3,010 )
Defined benefit pension plan:				
Net gain (loss) arising during period	8	2	11	3
Total defined benefit pension plan	8	2	11	3
Unrealized gains/(losses) on change in fair value of interest rate swaps <sup>(2)</sup>	1,065	(410 )	922	(615 )
Other comprehensive income (loss)	(12,588 )	(2,022 )	(11,439 )	(3,622 )
Comprehensive income	\$15,690	\$22,860	\$38,271	\$41,265

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

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



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

	Common Stock		Additional Paid-in Capital	Tax Benefit From Stock Based Compensation	Accumulated Other Comprehensive Income(Loss)	Retained Earnings	Treasury Stock		Total Equity
	Shares	Amount					Shares	Amount	
Balance at August 31, 2012	30,856	\$ 3	\$384,154	\$ 6,680	\$ (33,182 )	\$77,739	645	\$(16,480)	\$418,914
Purchase of treasury stock	—	—	—	—	—	—	42	(3,235 )	(3,235 )
Issuance of restricted stock award	12	—	—	—	—	—	—	—	—
Forfeiture of restricted stock awards	(1 )	—	—	—	—	—	—	—	—
Exercise of stock options	3	—	47	—	—	—	—	—	47
Stock-based compensation	—	—	3,491	829	—	—	—	—	4,320
Dividend paid to stockholders	—	—	—	—	—	(9,065 )	—	—	(9,065 )
Dividend payable to stockholders	—	—	—	—	—	(9,065 )	—	—	(9,065 )
Net income	—	—	—	—	—	44,887	—	—	44,887
Other comprehensive income (loss)	—	—	—	—	(3,622 )	—	—	—	(3,622 )
Balance at February 28, 2013	30,870	\$ 3	\$387,692	\$ 7,509	\$ (36,804 )	\$104,496	687	\$(19,715)	\$443,181
Balance at August 31, 2013	30,924	\$ 3	\$390,581	\$ 8,016	\$ (41,475 )	\$143,871	690	\$(19,947)	\$481,049
Purchase of treasury stock	—	—	—	—	—	—	48	(4,548 )	(4,548 )
Issuance of restricted stock award	16	—	—	—	—	—	—	—	—
Forfeiture of restricted stock awards	(1 )	—	—	—	—	—	—	—	—
Exercise of stock options	5	—	118	—	—	—	—	—	118
Stock-based compensation	—	—	3,321	1,345	—	—	—	—	4,666
Dividend paid to stockholders	—	—	—	—	—	(10,570 )	—	—	(10,570 )

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Dividend payable to stockholders	—	—	—	—	—	(10,593 )	—	—	(10,593 )
Net income	—	—	—	—	—	49,710	—	—	49,710
Other comprehensive income (loss)	—	—	—	—	(11,439 )	—	—	—	(11,439 )
Balance at February 28, 2014	30,944	\$ 3	\$ 394,020	\$ 9,361	\$ (52,914 )	\$ 172,418	738	\$(24,495)	\$ 498,393

See accompanying notes.

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

	Six Months Ended February 28,	
	2014	2013
Operating Activities:		
Net income	\$49,710	\$44,887
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	13,793	11,715
Allowance for doubtful accounts	6	—
Loss on sale of property and equipment	188	104
Deferred income taxes	1,857	2,031
Excess tax (benefit) on stock-based compensation	(1,345)	(829)
Equity in (gains)/losses of unconsolidated affiliates	(4)	8
Stock-based compensation	3,321	3,491
Change in operating assets and liabilities:		
Change in receivables, prepaid expenses and other current assets, accrued salaries and benefits, deferred membership income and other accruals	(12,839)	(4,853)
Merchandise inventories	(19,058)	(18,411)
Accounts payable	81	22,974
Net cash provided by operating activities	35,710	61,117
Investing Activities:		
Additions to property and equipment	(58,096)	(38,676)
Deposits for land purchase option agreements	(850)	—
Proceeds from disposal of property and equipment	42	61
Capital contributions to joint ventures	(750)	(550)
Net cash flows (used in) investing activities	(59,654)	(39,165)
Financing Activities:		
Proceeds from bank borrowings	—	3,979
Repayment of bank borrowings	(12,012)	(3,757)
Cash dividend payments	(10,570)	(9,065)
Release of restricted cash	8,000	2,000
Excess tax benefit on stock-based compensation	1,345	829
Purchase of treasury stock	(4,548)	(3,235)
Proceeds from exercise of stock options	118	47
Net cash (used in) financing activities	(17,667)	(9,202)
Effect of exchange rate changes on cash and cash equivalents	(4,926)	(2,796)
Net (decrease) increase in cash and cash equivalents	(46,537)	9,954
Cash and cash equivalents at beginning of period	121,874	91,248
Cash and cash equivalents at end of period	\$75,337	\$101,202
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest, net of amounts capitalized	\$1,893	\$2,357
Income taxes	\$22,326	\$18,090
Supplemental non-cash item:		
Dividends declared but not paid	\$10,593	\$9,065



PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

February 28, 2014

NOTE 1 – COMPANY OVERVIEW AND BASIS OF PRESENTATION

PriceSmart, Inc.'s ("PriceSmart" or the "Company") business consists primarily of international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. As of February 28, 2014, the Company had 32 consolidated warehouse clubs in operation in 12 countries and one U.S. territory (six in Costa Rica, four each in Panama and Trinidad, three each in Colombia, Guatemala and in the Dominican Republic, two each in El Salvador and Honduras and one each in Aruba, Barbados, Jamaica, Nicaragua and the United States Virgin Islands), of which the Company owns 100% of the corresponding legal entities (see Note 2 - Summary of Significant Accounting Policies). During fiscal 2013, the Company opened its second and third clubs in Colombia. These clubs are in south and north Cali and opened in October 2012 and May 2013, respectively. On January 8, 2014, the Company acquired land in the southern area of Pereira, Colombia, upon which the Company plans to construct a new warehouse club that is currently planned to open in November 2014. On January 30, 2014, the Company acquired land in the city of Medellin, Colombia and leased land in the city of Bogota, Colombia, upon which the Company plans to construct new warehouse clubs. These warehouse clubs are currently planned to open before the end of calendar year 2014. Together with the three warehouse clubs currently operating in Colombia (one in Barranquilla and two in Cali), these three new clubs will bring the number of PriceSmart warehouse clubs operating in Colombia to six. In October 2013, the Company opened its sixth membership warehouse club in Costa Rica in La Union, Cartago. Additionally, in February 2013, the Company acquired land in Tegucigalpa, Honduras upon which it anticipates opening its third warehouse club in Honduras in May 2014. The Company continues to explore other potential sites for future warehouse clubs in Central America, the Caribbean and Colombia. The warehouse club sales and membership sign-ups experienced with the opening of the Barranquilla and Cali warehouse clubs have reinforced the Company's belief that Colombia could be a market for additional PriceSmart warehouse clubs in other Colombian cities.

Basis of Presentation - The interim consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2013 (the "2013 Form 10-K"). The interim consolidated financial statements include the accounts of PriceSmart, Inc., a Delaware corporation, and its subsidiaries. Inter-company transactions between the Company and its subsidiaries have been eliminated in consolidation.

In accordance with the Financial Accounting Standards Board's ("FASB") revised guidance establishing general accounting standards and disclosure of subsequent events, the Company has evaluated subsequent events through the date and time these financial statements were issued.

Reclassifications to consolidated statement of income recorded during fiscal year 2014 for fiscal year 2013 - The Company recorded asset disposal activity during fiscal year 2013 under other income (expense), net. This activity consisted mainly of normally scheduled asset replacement and upgrades involved in operating activities. The Company has determined that these costs represent operating expenses. Therefore, the Company has accordingly recorded such asset disposal activity as operating expenses under loss/(gain) on disposal of assets starting in fiscal year 2014. The Company has made reclassifications to the consolidated statement of income for fiscal year 2013 to conform to the presentation in fiscal year 2014. These reclassifications did not impact net income. The following tables summarize the impact of this reclassification (in thousands):



## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Fiscal Year 2013				
	Three Months Ended				
	November 30, 2012	February 28, 2013	May 31, 2013	August 31, 2013	Total Fiscal Year 2013
Other income (expense), net – as previously reported	\$ (58 )	\$ (312 )	\$ (1,034 )	\$ (439 )	\$ (1,843 )
Loss/(gain) on disposal of assets, other income (expense), net reclassified to Loss/(gain) on disposal of assets, total operating expenses	57	47	249	536	889
Other income (expense), net – as currently reported	\$ (1 )	\$ (265 )	\$ (785 )	\$ 97	\$ (954 )

	Three Months Ended				
	November 30, 2012	February 28, 2013	May 31, 2013	August 31, 2013	Total Fiscal Year 2013
Composition of beginning balance of other income (expense) – as previously reported:					
Gain/(loss) on sale	\$ (57 )	\$ (47 )	\$ (249 )	\$ (536 )	\$ (889 )
Currency gain/(loss)	(1 )	(265 )	(785 )	97	(954 )
Total	\$ (58 )	\$ (312 )	\$ (1,034 )	\$ (439 )	\$ (1,843 )

Composition of ending balance of other income (expense) – as currently reported:					
Gain/(loss) on sale	\$ —	\$ —	\$ —	\$ —	\$ —
Currency gain/(loss)	(1 )	(265 )	(785 )	97	(954 )
Total	\$ (1 )	\$ (265 )	\$ (785 )	\$ 97	\$ (954 )

## 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation – The interim consolidated financial statements of the Company included herein include the assets, liabilities and results of operations of the Company’s wholly owned subsidiaries and the Company’s investment in, and the Company’s share of the income (loss) of, joint ventures recorded under the equity method. All significant inter-company accounts and transactions have been eliminated in consolidation. The interim consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the SEC, and reflect all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary to fairly present the financial position, results of operations, and cash flows for the periods presented. The results for interim periods are not necessarily indicative of the results for the full year. As of February 28, 2014, all of the Company’s subsidiaries were wholly owned. Additionally, the Company’s ownership interest in real estate development joint

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ventures as of February 28, 2014 is listed below:

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

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



## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

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

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

	February 28, 2014	August 31, 2013
Short-term restricted cash:		
Restricted cash for Honduras loan	\$ 1,200	\$ 1,200
Restricted cash in Honduras for purchase of property	200	3,148
Restricted cash for land purchase option agreements	850	1,599
Other short-term restricted cash <sup>(1)</sup>	78	37
Total short-term restricted cash	\$ 2,328	\$ 5,984
Long-term restricted cash:		
Restricted cash for Honduras loan	\$ 1,720	\$ 1,720
Restricted cash for Colombia bank loans	24,000	32,000
Other long-term restricted cash <sup>(1)</sup>	1,040	1,055
Total long-term restricted cash	\$ 26,760	\$ 34,775
Total restricted cash	\$ 29,088	\$ 40,759

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

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Value Added Tax Receivable - The Company pays Value Added Tax (“VAT”) or similar taxes (“input VAT”) within the normal course of its business in most of the countries it operates in on merchandise and/or services it acquires. The Company also collects VAT or similar taxes on behalf of the government (“output taxes”) for merchandise and/or services it sells. If the output VAT exceeds the input VAT, then the difference is remitted to the government, usually on a monthly basis. If the input VAT exceeds the output VAT, this creates a VAT receivable. The Company either requests a refund of this VAT receivable or applies the balance to expected future VAT payables. In some countries where the Company operates, the governments have implemented additional collection procedures, such as requiring credit card processors to remit a portion of sales processed via credit card directly to the government. These procedures alter the natural offset of input and output VAT and generally leaves the Company with a net VAT receivable, forcing the Company to process significant refund claims on a recurring basis. These refund processes can take anywhere from several months to several years to complete.

In most countries where the Company operates, the VAT refund process is defined and structured with regular refunds or offsets. However, in one country the government has alleged that there is no defined process in the law to allow them to refund this VAT receivable. The Company together with its tax and legal advisers is currently appealing this interpretation in court and based on recent favorable jurisprudence on this matter, expects to prevail. Additionally, the government has recently begun an audit to verify the amount of this receivable as a required precursor to any refund. Therefore, the Company has not placed any type of allowance on the recoverability of this VAT receivable. The balance of the VAT receivable in this country was \$4.7 million and \$4.3 million as of February 28, 2014 and August 31, 2013, respectively.

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

- Short-term VAT receivables, recorded as Other current assets: This classification is used for any countries where the Company's subsidiary has generally demonstrated the ability to recover the VAT receivable within one year. The Company also classifies as short-term any approved refunds or credit notes to the extent that the Company expects to receive the refund or use the credit notes within one year.

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

	February 28, 2014	August 31, 2013
Prepaid expenses and other current assets	\$5,304	\$5,458
Other non-current assets	\$16,610	\$12,875

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

and lessor-paid tenant improvements. In addition to the minimum annual payments, in certain locations, the Company pays additional contingent rent based on a contractually stipulated percentage of sales.

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

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

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

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

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

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

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

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

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

**Long-term debt:** The fair value of debt is generally measured using a discounted cash flow analysis based on current market interest rates for similar types of financial instruments. These inputs are not quoted prices in active markets but they are either directly or indirectly observable; therefore, they are classified as Level 2 inputs. The carrying value and fair value of the Company's debt as of February 28, 2014 and August 31, 2013 is as follows (in thousands):

February 28, 2014		August 31, 2013	
Carrying Value	Fair Value	Carrying Value	Fair Value

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Long-term debt, including current portion	\$ 60,195	\$ 60,710	\$ 73,020	\$ 72,576
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Derivatives Instruments and Hedging Activities - The Company uses derivative financial instruments for hedging and non-trading purposes to manage its exposure to changes in interest and currency exchange rates. In using derivative financial instruments for the purpose of hedging the Company's exposure to interest and currency exchange rate risks, the contractual terms of a hedged instrument closely mirror those of the hedged item, providing a high degree of risk reduction and correlation. Contracts that are effective at meeting the risk reduction and correlation criteria (effective hedge) are recorded using hedge accounting. If a derivative financial instrument is an effective hedge, changes in the fair value of the instrument will be offset in accumulated other comprehensive income (loss) until the hedged item completes its contractual term. If any portion of the hedge is deemed

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

ineffective, the change in fair value of the hedged assets or liabilities will be immediately recognized in earnings during the period. Instruments that do not meet the criteria for hedge accounting, or contracts for which the Company has not elected hedge accounting, are valued at fair value with unrealized gains or losses reported in earnings during the period of the change. Valuation techniques utilized in the fair value measurement of assets and liabilities presented on the Company's consolidated balance sheets were not changed from previous practice during the reporting period.

**Cash Flow Instruments.** The Company is a party to receive floating interest rate, pay fixed-rate interest rate swaps to hedge the interest rate risk of certain U.S. denominated debt within its international subsidiaries whose functional currency is other than the U.S. dollar. The swaps are designated as cash flow hedges of interest expense risk. These instruments are considered effective hedges and are recorded using hedge accounting. The Company is also a party to receive variable interest rate, pay fixed interest rate cross-currency interest rate swaps to hedge the interest rate and currency exposure associated with the expected payments of principal and interest of U.S. denominated debt within its international subsidiaries whose functional currency is other than the U.S. dollar. The swaps are designated as cash flow hedges of the currency risk related to payments on the U.S. denominated debt. These instruments are also considered to be effective hedges and are recorded using hedge accounting. Under cash flow hedging, the effective portion of the fair value of the derivative, calculated as the net present value of the future cash flows, is deferred on the consolidated balance sheets in accumulated other comprehensive loss. If any portion of an interest rate swap is determined to be an ineffective hedge, the gains or losses from changes in fair value would be recorded directly in the consolidated statements of income. For cash flow hedges that were previously considered effective and are now considered ineffective hedges, amounts previously recorded in accumulated other comprehensive gain or loss are released to earnings in the same period that the hedged transaction has been determined to be ineffective and impacts consolidated earnings. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of interest rate swaps and cross-currency interest rate swaps as of February 28, 2014 and August 31, 2013.

**Fair Value Instruments.** The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business. The Company is also exposed to foreign-currency exchange-rate fluctuations on U.S. dollar denominated liabilities within its international subsidiaries whose functional currency is other than the U.S. dollar. The Company manages these fluctuations, in part, through the use of non-deliverable forward foreign-exchange contracts that are intended to offset changes in cash flow attributable to currency exchange movements. The contracts are intended primarily to economically address exposure to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries whose functional currency is other than the U.S. dollar. Currently, these contracts are treated for accounting purposes as fair value instruments and do not qualify for derivative hedge accounting. As a result, these contracts are valued at fair value with unrealized gains or losses reported in earnings during the period of the change. The Company seeks to mitigate foreign-currency exchange-rate risk with the use of these contracts and does not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features.

The Company seeks to manage counterparty risk associated with these contracts by limiting transactions to counterparties with which the Company has an established banking relationship. There can be no assurance, however, that this practice effectively mitigates counterparty risk. The contracts are limited to less than one year in duration. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of open, unsettled forward foreign-exchange contracts as of February 28, 2014 and August 31, 2013.

The following table summarizes financial assets and liabilities measured and recorded at fair value on a recurring basis in the Company's consolidated balance sheet as of February 28, 2014 and August 31, 2013 (in thousands) for derivatives that qualify for hedge accounting:

12

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## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Assets and Liabilities as of February 28, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Prepaid expenses and other current assets (Cross-currency interest rate swaps)	\$—	\$ 891	\$—	\$ 891
Other non-current assets - (Cross-currency interest rate swaps)	—	1,969	—	1,969
Other long-term liabilities – (Interest rate swaps)	—	—	—	—
Other long-term liabilities – (Cross-currency interest rate swaps)	—	—	—	—
Total	\$—	\$ 2,860	\$—	\$ 2,860

  

Assets and Liabilities as of August 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Prepaid expenses and other current assets (Cross-currency interest rate swaps)	\$—	\$—	\$—	\$—
Other non-current assets - (Cross-currency interest rate swaps)	—	1,505	—	1,505
Other long-term liabilities – (Interest rate swaps)	—	(14 )	—	(14 )
Other long-term liabilities – (Cross-currency interest rate swaps)	—	—	—	—
Total	\$—	\$ 1,491	\$—	\$ 1,491

The following table summarizes financial assets and liabilities measured and recorded at fair value on a recurring basis in the Company's consolidated balance sheet as of February 28, 2014 and August 31, 2013 (in thousands) for derivatives that do not qualify for hedge accounting:

Assets and Liabilities as of February 28, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Prepaid expenses and other current assets (Foreign currency forward contracts)	\$—	\$ 1	\$—	\$ 1



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Other accrued expenses (Foreign currency forward contracts)	—	(55	)	—	(55	)
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting	\$—	\$(54	)	\$—	\$(54	)

13

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## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Assets and Liabilities as of August 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Prepaid expenses and other current assets (Foreign currency forward contracts)	\$—	\$—	\$—	\$—
Other accrued expenses (Foreign currency forward contracts)	—	—	—	—
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting	\$—	\$—	\$—	\$—

As of February 28, 2014 and August 31, 2013, the Company had no significant measurements of financial assets or liabilities at fair value on a nonrecurring basis.

Goodwill – The table below presents goodwill resulting from certain business combinations as of February 28, 2014 and August 31, 2013 (in thousands). The change in goodwill is a result of foreign exchange translation losses.

	February 28, 2014	August 31, 2013	Change
Goodwill	\$36,321	\$36,364	\$(43 )

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

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

The Company began offering Platinum memberships in Costa Rica during fiscal year 2013, which provides members with a 2% rebate on most items, up to an annual maximum of \$500.00. Platinum members can apply this rebate to future purchases at the warehouse club at the end of the annual membership period. The Company records this 2% rebate as a reduction of revenue at the time of the sales transaction. Accordingly, the Company has reduced warehouse sales and has accrued a liability within other accrued expenses. The rebate expires within six months of the membership renewal date. However, the Company has determined that in the absence of relevant historical

experience, the Company is not able to make a reasonable estimate of rebate redemptions and accordingly has assumed a 100% redemption rate. The Company periodically reviews expired unused rebates outstanding, and the expired unused rebates are recognized as Revenues: Other income on the consolidated statements of income. The Company recognizes gift certificate sales revenue when the certificates are redeemed. The outstanding gift certificates are reflected as other accrued expenses in the consolidated balance sheets. These gift certificates generally have a one-year stated expiration date from the date of issuance. However, the absence of a large volume of transactions for gift certificates impairs the Company's ability to make a reasonable estimate of the redemption levels for gift certificates. Therefore, the Company assumes a 100% redemption rate that is the equivalent of no breakage prior to expiration of the gift certificate. The Company periodically reviews unredeemed outstanding gift certificates, and the gift certificates that have expired are recognized as Revenues: Other income on the consolidated statements of income.

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

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

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

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

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

Contingencies and Litigation – The Company accounts for and reports loss contingencies if (a) information available prior to issuance of the consolidated financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the consolidated financial statements and (b) the amount of loss can be reasonably estimated.

Foreign Currency Translation – The assets and liabilities of the Company’s foreign operations are translated to U.S. dollars when the functional currency in the Company’s international subsidiaries is the local currency and not U.S. dollars. Assets and liabilities of these foreign subsidiaries are translated to U.S. dollars at the exchange rate on the balance sheet date, and revenue, costs and expenses are translated at average rates of exchange in effect during the period. The corresponding translation gains and losses are recorded as a component of accumulated other comprehensive income or loss. These adjustments will affect net income upon the sale or liquidation of the underlying investment. Monetary assets and liabilities denominated in currencies other than the functional currency of the respective entity (primarily U.S. Dollars) are revalued to the functional currency using the exchange rate on the balance sheet date. These foreign exchange transaction gains (losses), including transactions recorded involving these monetary assets and liabilities, are recorded as Other income (expense) in the consolidated statements of income. The following table summarizes the amounts recorded for the three and six month periods ending February 28, 2014 and 2013 (in thousands):

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Three Months Ended		Six Months Ended	
	February 28, 2014	February 28, 2013	February 28, 2014	February 28, 2013
Currency gain (loss)	\$ 712	\$(265	) \$ 1,023	\$(264

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

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

The Company accrues an amount for its estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained. This requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. When facts and circumstances change, the Company reassesses these probabilities and records any changes in the consolidated financial statements as appropriate. There were no material changes in the Company's uncertain income tax positions for the periods ended February 28, 2014 and 2013. However, during the six months ended February 28, 2014, the Company was required to make a payment to the government in one country with respect to an income tax case that it is currently appealing, but continues to believe it will eventually prevail. The total amount remitted to the government on this case as of this date is \$2.7 million. This amount has been recorded in the balance sheet as Other non-current assets, as the Company considers this a payment on account and expects to get a refund thereof upon eventually prevailing on this case.

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

	Three Months Ended		Six Months Ended	
	February 28, 2014	February 28, 2013	February 28, 2014	February 28, 2013
Federal tax provision at statutory rates	35.0	% 35.0	% 35.0	% 35.0
State taxes, net of federal benefit	0.2	0.2	0.3	0.2
Differences in foreign tax rates	(5.3	) (4.7	) (4.8	) (4.6
	(1.8	) (2.1	) (0.2	) (1.3

## Permanent items and other adjustments

Increase (decrease) in foreign valuation allowance	0.1		1.0		(0.1	)	0.6	
Provision for income taxes	28.2		% 29.4		% 30.2		% 29.9	%

The variance in the effective tax rate for the three-month period ended on February 28, 2014 compared to the same period of the prior year was primarily attributable to the favorable discrete impact of 0.5% resulting from changes in foreign income tax rates, 0.6% resulting from reversals of income tax liability for uncertain tax positions and 0.8% resulting from a decrease in taxable losses of the Company's Colombia affiliate, partially offset by the 0.9% unfavorable variance resulting from the establishment during fiscal year 2013 of a deferred tax asset related to estimated 2013 state taxes.

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The variance in the effective tax rate for the first six months of the period ended on February 28, 2014 compared to the same period of the prior year was primarily attributable to the favorable discrete impact of 0.7% resulting from a decrease in taxable losses of the Company's Colombia affiliate, partially offset by the 0.5% unfavorable variance resulting from the establishment during fiscal year 2013 of a deferred tax asset related to estimated 2013 state taxes.

#### Recent Accounting Pronouncements

FASB ASC 405 ASU 2013-04 - Obligations resulting from joint and several liability arrangements.

In February 2013, the FASB issued amendments providing guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this update is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. The guidance requires an entity to measure those obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance in this update also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The amendment was retrospectively effective for the Company as of September 1, 2013. Adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

FASB ASC 220 ASU 2013-02 - Reporting of amounts reclassified out of accumulated other comprehensive income.

In February 2013, the FASB issued amended guidance for the presentation requirements for reclassifications out of accumulated other comprehensive income. The amendment requires the Company to provide additional information about reclassifications of accumulated other comprehensive income. The amendment was effective as of March 1, 2013. The Company adopted this guidance on March 1, 2013. Adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

FASB ASC 220 ASU 2011-05 - Presentation of comprehensive income.

In June 2011, the FASB issued guidance to amend the presentation of comprehensive income to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amended guidance was effective for annual and interim periods within those years beginning after December 15, 2011 and was to be applied retrospectively. The Company adopted this guidance on September 1, 2012. Adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

FASB ASC 350 ASU 2010-28 - When to perform step 2 of the Goodwill impairment test.

In December 2010, the FASB issued amended guidance concerning testing for impairment of goodwill where an entity has one or more reporting units whose carrying value is zero or negative. The amended guidance requires the



entity to perform a test to measure the amount, if any, of impairment to goodwill by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. The Company was required to adopt this amended guidance for fiscal years or interim periods within those years after December 15, 2011. The Company adopted this guidance on September 1, 2012. The adoption of the amended guidance did not have an impact on the Company's consolidated financial statements or disclosures to those financial statements.

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 3 – PROPERTY AND EQUIPMENT

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

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

	February 28, 2014	August 31, 2013
Land	\$ 116,996	\$ 100,108
Building and improvements	234,645	228,257
Fixtures and equipment	135,747	119,242
Construction in progress	29,074	23,657
Total property and equipment, historical cost	516,462	471,264
Less: accumulated depreciation	(142,127)	) (132,786)
Property and equipment, net	\$ 374,335	\$ 338,478

Depreciation and amortization expense (in thousands):

	Three Months Ended February 28,		Six Months Ended February 28,	
	2014	2013	2014	2013
Depreciation and amortization expense	\$ 7,139	\$ 6,031	\$ 13,793	\$ 11,715

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

Total interest capitalized (in thousands):

	As of February 28, 2014	As of August 31, 2013
Total interest capitalized	\$ 4,418	\$ 4,475

Total interest capitalized (in thousands):

	Three Months Ended February 28,		Six Months Ended February 28,	
	2014	2013	2014	2013
Interest capitalized	\$ 194	\$ 110	\$ 493	\$ 281



PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 4 – EARNINGS PER SHARE

The Company presents basic and diluted net income per share using the two-class method. The two-class method is an earnings allocation formula that treats a participating security as having rights to earnings that otherwise would have been available to common stockholders and that determines basic net income per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings that would have been available to common stockholders. A participating security is defined as a security that may participate in undistributed earnings with common stock. The Company's capital structure includes securities that participate with common stock on a one-for-one basis for distribution of dividends. These are the restricted stock awards authorized within the 2002 and 2013 Equity Participation Plans/Equity Incentive Awards Plan of the Company and restricted stock units authorized within the 2001, 2002 and 2013 Equity Participation Plans/Equity Incentive Awards Plan. In addition, the Company determines the diluted net income per share by using the more dilutive of the two class-method or the treasury stock method and by including the basic weighted average of outstanding stock options in the calculation of diluted net income per share under the two class-method and including all potential common shares assumed issued in the calculation of diluted net income per share under the treasury stock method.

The following table sets forth the computation of net income per share for the three and six months ended February 28, 2014 and 2013 (in thousands, except per share amounts):

	Three Months Ended February 28,		Six Months Ended February 28,	
	2014	2013	2014	2013
Net income	\$28,278	\$24,882	\$49,710	\$44,887
Less: Allocation of income to unvested stockholders	(504	) (540	) (932	) (964
Net earnings available to common stockholders	\$27,774	\$24,342	\$48,778	\$43,923
Basic weighted average shares outstanding	29,724	29,626	29,707	29,609
Add dilutive effect of stock options (two-class method)	12	10	12	11
Diluted average shares outstanding	29,736	29,636	29,719	29,620
Basic net income per share	\$0.93	\$0.82	\$1.64	\$1.48
Diluted net income per share	\$0.93	\$0.82	\$1.64	\$1.48

## NOTE 5 – STOCKHOLDERS' EQUITY

## Dividends

The following table summarizes the dividends declared and paid during fiscal year 2014 and 2013.

Declared	Amount	First Payment			Amount	Second Payment			Amount
		Record Date	Date Paid	Date Payable		Record Date	Date Paid	Date Payable	
1/23/14	\$0.70	2/14/14	2/28/14	N/A	\$0.35	8/15/14	N/A	8/29/14	\$0.35
11/27/12	\$0.60	12/10/12	12/21/12	N/A	\$0.30	8/15/13	8/30/13	N/A	\$0.30

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

## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## Comprehensive Income and Accumulated Other Comprehensive Loss

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

	Three Months Ended February 28, 2014			2013		
	Before-Tax Amount	Tax (expense) or benefit	Net-of-Tax Amount	Before-Tax Amount	Tax (expense) or benefit	Net-of-Tax Amount
Foreign currency translation adjustments <sup>(1)</sup>	\$(13,661 )	\$—	\$(13,661 )	\$(1,614 )	\$—	\$(1,614 )
Defined benefit pension plans:						
Net gain (loss) arising during period	7	1	8	2	—	2
Total defined pension plans	7	1	8	2	—	2
Unrealized gains (losses) on change in fair value of interest rate swaps <sup>(2)</sup>	1,545	(480 )	1,065	(400 )	(10 )	(410 )
Other comprehensive income (loss)	\$(12,109 )	\$(479 )	\$(12,588 )	\$(2,012 )	\$(10 )	\$(2,022 )

	Six Months Ended February 28, 2014			2013		
	Before-Tax Amount	Tax (expense) or benefit	Net-of-Tax Amount	Before-Tax Amount	Tax (expense) or benefit	Net-of-Tax Amount
Foreign currency translation adjustments <sup>(1)</sup>	\$(12,372 )	\$—	\$(12,372 )	\$(3,010 )	\$—	\$(3,010 )
Defined benefit pension plans:						
Net gain (loss) arising during period	12	(1 )	11	1	2	3
Total defined pension plans	12	(1 )	11	1	2	3
Unrealized gains (losses) on change in fair value of interest rate swaps <sup>(2)</sup>	1,369	(447 )	922	(584 )	(31 )	(615 )
Other comprehensive income (loss)	\$(10,991 )	\$(448 )	\$(11,439 )	\$(3,593 )	\$(29 )	\$(3,622 )

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

(1)

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



## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following tables disclose the changes in the balances of each component of other comprehensive loss included as a separate component of equity within the balance sheet and for each component of other comprehensive income, the current period reclassifications out of accumulated other comprehensive income (in thousands):

	Six Months Ended February 28, 2014			
	Foreign currency translation adjustments	Defined benefit pension plans	Unrealized gains/(losses) on change in fair value of interest rate swaps <sup>(1)</sup>	Accumulated other comprehensive loss
Beginning balance, September 1, 2013	\$ (42,321 )	\$ (152 )	\$ 998	\$ (41,475 )
Other comprehensive income before reclassifications	(12,372 )	—	—	(12,372 )
Amounts reclassified from accumulated other comprehensive income	—	11	922	<sup>(1)</sup> 933
Net current-period other comprehensive income	(12,372 )	11	922	(11,439 )
Ending Balance February 28, 2014	\$ (54,693 )	\$ (141 )	\$ 1,920	\$ (52,914 )
	Six Months Ended February 28, 2013			
	Foreign currency translation adjustments	Defined benefit pension plans	Unrealized gains/(losses) on change in fair value of interest rate swaps <sup>(1)</sup>	Accumulated other comprehensive loss
Beginning balance, September 1, 2012	\$ (31,962 )	\$ (74 )	\$ (1,146 )	\$ (33,182 )
Other comprehensive income before reclassifications	(3,010 )	—	—	(3,010 )
Amounts reclassified from accumulated other comprehensive income	—	3	(615 )	<sup>(1)</sup> (612 )
Net current-period other comprehensive income	(3,010 )	3	(615 )	(3,622 )
Ending Balance February 28, 2013	\$ (34,972 )	\$ (71 )	\$ (1,761 )	\$ (36,804 )
	Twelve Months Ended August 31, 2013			
	Foreign currency translation adjustments	Defined benefit pension plans	Unrealized gains/(losses) on change in fair value of interest rate swaps <sup>(1)</sup>	Accumulated other comprehensive loss
Beginning balance, September 1, 2012	\$ (31,962 )	\$ (74 )	\$ (1,146 )	\$ (33,182 )
Other comprehensive income before reclassifications	(10,359 )	—	—	(10,359 )
Amounts reclassified from accumulated other comprehensive income	—	(78 )	2,144	<sup>(1)</sup> 2,066
Net current-period other comprehensive income	(10,359 )	(78 )	2,144	(8,293 )



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Ending balance, August 31, 2013                      \$(42,321        )    \$(152        )    \$998    \$(41,475        )

<sup>(1)</sup> See Note 9 - Derivative Instruments and Hedging Activities.

## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following tables disclose the effects on net income of amounts reclassified out of each component of accumulated other comprehensive loss (in thousands):

	Six Months Ended February 28, 2014		February 28, 2013		Twelve Months Ended August 31, 2013	
	Amount reclassified from accumulated other comprehensive (loss) income	Financial statement line item where effect is presented	Amount reclassified from accumulated other comprehensive (loss) income	Financial statement line item where effect is presented	Amount reclassified from accumulated other comprehensive (loss) income	Financial statement line item where effect is presented
Amortization of Defined benefit pension plan						
Prior service costs	\$—	(1)	\$—	(1)	\$260	(1)
Actuarial gains (losses)	12	(1)	1	(1)	(365	) (1)
Total before tax	12		1		(105	)
Tax (expense) benefit	(1	)	2		27	
Net of tax	\$11	(1)	\$3	(1)	\$(78	) (1)
Unrealized gains/(losses) on change in fair value of interest rate swaps						
Cross currency interest rate cash flow hedges	\$464	Balance sheet- other non-current assets	\$—	Balance sheet- other non-current assets	\$1,505	Balance sheet-other non-current assets
Cross currency interest rate cash flow hedges	891	Prepaid expenses and current assets	—	Prepaid expenses and current assets	—	Prepaid expenses and current assets
Interest rate cash flow hedges	14	Balance sheet- other long-term liabilities	124	Balance sheet- other long-term liabilities	203	Balance sheet-other long-term liabilities
Cross currency interest rate cash flow hedges	—	Balance sheet- other long-term liabilities	(708	)	983	Balance sheet-other long-term liabilities
Total before tax	1,369		(584	)	2,691	
Tax expense	(4	)	(31	)	(50	)
		Balance sheet- Deferred tax		Balance sheet- Deferred tax		Balance sheet- Deferred tax

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		assets		assets		assets
		Balance		Balance		Balance
Tax expense	(443	) sheet-	—	) sheet-	(497	) sheet-
		Deferred tax		Deferred tax		Deferred tax
		liabilities		liabilities		liabilities
		Balance		Balance		Balance
Net of tax	\$922	sheet- other	\$(615	) sheet- other	\$2,144	sheet-other
		long-term		long-term		long-term
		liabilities		liabilities		liabilities

(1) These amounts are included as part of salaries reported within the statement of income; warehouse club operations.

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## Retained Earnings Not Available for Distribution

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

	February 28, 2014	August 31, 2013
Retained earnings not available for distribution	\$4,472	\$4,171

## NOTE 6 – STOCK BASED COMPENSATION

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

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

The Company adopted the 2013 Equity Incentive Award Plan (the "2013 Plan") for the benefit of its eligible employees, consultants and non-employee directors on January 22, 2013. The 2013 Plan provides for awards covering up to (1) 600,000 shares of common stock plus (2) the number of shares that remained available for issuance as of January 22, 2013 under three equity participation plans previously maintained by the Company. The number of shares reserved for issuance under the 2013 Plan increases during the term of the plan by the number of shares relating to awards outstanding under the 2013 Plan or any of the prior plans that expire, or are forfeited, terminated, canceled or repurchased, or are settled in cash in lieu of shares. However, in no event will more than an aggregate of 1,531,818 shares of the Company’s common stock be issued under the 2013 Plan. The following table summarizes the shares authorized and shares available for future grants:

	Shares authorized for issuance (including shares originally authorized for issuance under the prior plans)	Shares available to grant	
		February 28, 2014	August 31, 2013
2013 Plan	838,766	824,092	782,385



## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

	Three Months Ended February 28,		Six Months Ended February 28,	
	2014	2013	2014	2013
Options granted to directors	\$7	\$21	\$37	\$54
Restricted stock awards	1,634	1,432	2,783	2,982
Restricted stock units	250	215	501	455
Stock-based compensation expense	\$1,891	\$1,668	\$3,321	\$3,491

The following table summarizes other information related to stock-based compensation:

	February 28,	
	2014	2013
Remaining unrecognized compensation cost (in thousands)	\$23,520	\$24,176
Weighted average period of time over which this cost will be recognized (years)	6	8
Excess tax benefit (deficiency) on stock-based compensation (in thousands)	\$1,345	\$829

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

	Six Months Ended February 28,	
	2014	2013
Grants outstanding at beginning of period	623,424	700,893
Granted	8,316	6,264
Forfeited	(1,732)	(1,370)
Vested	(135,371)	(123,820)
Grants outstanding at end of period	494,637	581,967

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

	Six Months Ended February 28,	
	2014	2013
Weighted Average Grant Date Fair Value		
Restricted stock awards and units granted	\$112.37	\$82.87
Restricted stock awards and units vested	\$39.71	\$39.34
Restricted stock awards and units forfeited	\$49.37	\$19.85

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

	Six Months Ended February 28,	
	2014	2013
Total fair market value of restricted stock awards and units vested	\$ 12,749	\$ 9,589

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

	Six Months Ended February 28,	
	2014	2013
Shares repurchased	48,291	41,744
Cost of repurchase of shares (in thousands)	\$ 4,548	\$ 3,235

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

	Six Months Ended February 28,	
	2014	2013
Reissued treasury shares	—	—

The following table summarizes the stock options outstanding:

	February 28, 2014	August 31, 2013
Stock Options Outstanding	23,000	28,000

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

#### NOTE 7 – COMMITMENTS AND CONTINGENCIES

From time to time, the Company and its subsidiaries are subject to legal proceedings, claims and litigation arising in the ordinary course of business, the outcome of which, in the opinion of management, would not have a material adverse effect on the Company. The Company evaluates such matters on a case by case basis, and vigorously contests any such legal proceedings or claims which the Company believes are without merit.

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

disagree with respect to the interpretations the Company used to calculate its tax liability and therefore require the Company to pay additional taxes.

25

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

In evaluating the exposure associated with various non-income tax filing positions, the Company accrues for probable and estimable exposures for non-income tax related tax contingencies. As of February 28, 2014 and August 31, 2013, the Company had recorded within other accrued expenses a total of \$2.9 million for various non-income tax related tax contingencies.

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

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

Years ended February 28,	Open Locations <sup>(1)</sup>
2015	\$7,981
2016	8,200
2017	8,289
2018	8,873
2019	8,791
Thereafter	89,882
Total	\$132,016 <sup>(2)</sup>

<sup>(1)</sup> Operating lease obligations have been reduced by approximately \$687,000 to reflect sub-lease income. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.

On January 30, 2014, the Company entered into a lease agreement for approximately 126,000 usable square feet (11,667 usable square meters) of land in the city of Bogota, Colombia, upon which the Company plans to construct a new warehouse club. The lease term is for 30 years with two options to renew at the Company's discretion for ten <sup>(2)</sup> years each. The total expected payments under the initial term of this lease are included within the table and makes up part of the total lease commitments. The Company will record the monthly lease expense in pre-opening expenses while the warehouse club is under construction. Upon opening, these expenses will be recognized in warehouse club operations expense.

The Company is also committed to non-cancelable construction services obligations for various warehouse club developments and expansions. As of February 28, 2014 the Company has approximately \$25.6 million in contractual obligations for construction services not yet rendered.

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

The Company contracts for distribution center services in Mexico. The contract for this distribution center's services was renewed on December 31, 2011 for an additional three years, with the applicable fees and rates to be reviewed at the beginning of each calendar year. Future minimum service commitments related to this contract for the following twelve months is approximately \$104,000.

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 8 – DEBT

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

	Total Amount of Facilities	Facilities Used		Facilities Available	Weighted average interest rate
		Short-term Borrowings	Letters of Credit		
February 28, 2014	\$35,951	\$—	\$51	\$35,900	N/A
August 31, 2013	\$35,863	\$—	\$588	\$35,275	N/A

Each of the facilities expires annually and is normally renewed.

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

Twelve months ended February 28,	Amount
2015	\$18,887
2016	9,464
2017	24,037
2018	2,823
2019	1,922
Thereafter	3,062
Total	\$60,195

On November 3, 2013, the Company paid down \$8.0 million of the loan agreement entered into by the Company's Colombia subsidiary on November 1, 2010, with Citibank, N.A. in New York. The original agreement established a loan facility for \$16.0 million to be disbursed in two tranches of \$8.0 million each, but the Company never drew down the second tranche. The interest rate was set at the six-month LIBOR rate plus 2.4%. The loan term was for five years with interest only payments and a balloon payment at maturity. The loan facility was renewable for an additional five-year period at the option of the Company's Colombia subsidiary, but if the Company did not draw on the facility or paid off the loan, the facility would terminate. Accordingly, since the Company has paid down this loan, this loan facility has terminated. This loan was secured by a time deposit pledged by the Company equal to the amount outstanding on the loan. The secured time deposit of \$8.0 million pledged by the Company was released on November 3, 2013.

## NOTE 9 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

In addition, the Company is exposed to foreign currency and interest rate cash flow exposure related to a non-functional currency long-term debt of one of its wholly owned subsidiaries. To manage this foreign currency and interest rate cash flow exposure, the Company's subsidiary entered into a cross-currency interest rate swap that converts its foreign currency denominated floating interest payments to functional currency fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of interest payments, the hedge is intended to offset changes in cash flows attributable to interest rate and foreign exchange movements.

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

These derivative instruments (cash flow hedging instruments) are designated and qualify as cash flow hedges, with the effective portion of the gain or loss on the derivative reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction is determined to be ineffective. There were no such amounts recorded for ineffectiveness for the periods reported herein related to the interest rate or cross-currency interest rate swaps of long-term debt.

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business, particularly in the case of U.S. dollar denominated liabilities within its international subsidiaries whose functional currency is other than the U.S. dollar. The Company manages these fluctuations, in part, through the use of non-deliverable forward foreign-exchange contracts that are intended to offset changes in cash flow attributable to currency exchange movements. These contracts are intended primarily to economically address exposure to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries whose functional currency is other than the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. The Company seeks to mitigate foreign-currency exchange-rate risk with the use of these contracts and does not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features.

#### Cash Flow Hedges

The Company formally documents the hedging relationships for its derivative instruments that qualify for hedge accounting. As of February 28, 2014, all of the Company's cross-currency interest rate swap derivative financial instruments are designated and qualify as cash flow hedges. The cross-currency interest rate swap agreements convert the Company's subsidiary's foreign currency United States dollar denominated floating interest payments on long-term debt to the functional currency fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of interest payments, the hedge is intended to offset changes in cash flows attributable to interest rate and foreign currency exchange movements. Various subsidiaries entered into interest rate swap agreements that fix the interest rate over the life of the underlying loans. These derivative financial instruments were also designated and qualified as cash flow hedges.

## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes agreements for which the Company has recorded cash flow hedge accounting transactions during the six months ended February 28, 2014:

Subsidiary	Date Entered into	Derivative Financial Counter-party	Derivative Financial Instruments	Initial US Notional Amount (in thousands)	Bank US loan Held with	Floating Leg (swap counter-party)	Fixed Rate for PSMT Subsidiary	Settlement Reset Date	Effective Period of swap
Colombia	11-Dec-12	Bank of Nova Scotia ("Scotiabank")	Cross currency interest rate swap	\$8,000,000	Bank of Nova Scotia	Variable rate 3-month Libor plus 0.7%	4.79%	March, June, September and December, beginning on March 5, 2013	December 5, 2012 - December 5, 2014
Colombia	21-Feb-12	Bank of Nova Scotia ("Scotiabank")	Cross currency interest rate swap	\$8,000,000	Bank of Nova Scotia	Variable rate 3-month Libor plus 0.6%	6.02%	February, May, August and November beginning on May 22, 2012	February 21, 2012 - February 21, 2017
Colombia	17-Nov-11	Bank of Nova Scotia ("Scotiabank")	Cross currency interest rate swap	\$8,000,000	Citibank, N.A.	Variable rate 6-month Eurodollar Libor plus 2.4%	5.85%	May 3, 2012 and semi-annually thereafter	November 3, 2011 - November 3, 2013
Colombia	21-Oct-11	Bank of Nova Scotia ("Scotiabank")	Cross currency interest rate swap	\$2,000,000	Bank of Nova Scotia	Variable rate 3-month Libor plus 0.7%	5.30%	January, April, July and October, beginning on October 29, 2011	July 29, 2011 - April 1, 2016
Colombia	21-Oct-11	Bank of Nova Scotia ("Scotiabank")	Cross currency interest rate swap	\$6,000,000	Bank of Nova Scotia	Variable rate 3-month Libor plus 0.7%	5.45%	March, June, September and December, beginning on October 29, 2011	September 29, 2011 - April 1, 2016
Colombia	5-May-11	Bank of Nova Scotia ("Scotiabank")	Cross currency interest rate swap	\$8,000,000	Bank of Nova Scotia	Variable rate 3-month Libor plus 0.7%	6.09%	January, April, July and October, beginning on July 5, 2011	April 1, 2011 - April 1, 2016
Trinidad	20-Nov-08	Royal Bank of Trinidad & Tobago	Interest rate swaps	\$8,900,000	Royal Bank of Trinidad & Tobago	Variable rate 1-year Libor plus 2.75%	7.05%	Annually on August 26	September 25, 2008 - September 26, 2013



## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

For the three and six-month period ended February 28, 2014 and 2013, the Company included the gain or loss on the hedged items (that is, variable-rate borrowings) in the same line item—interest expense—as the offsetting gain or loss on the related interest rate swaps as follows (in thousands):

Income Statement Classification	Interest expense on borrowings <sup>(1)</sup>	Cost of swaps <sup>(2)</sup>	Total
Interest expense for the three months ended February 28, 2014	\$113	\$334	\$447
Interest expense for the three months ended February 28, 2013	\$179	\$463	\$642
Interest expense for the six months ended February 28, 2014	\$240	\$764	\$1,004
Interest expense for the six months ended February 28, 2013	\$377	\$860	\$1,237

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

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

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

Floating Rate Payer (Swap Counterparty)	February 28, 2014	August 31, 2013
RBTT	\$—	\$4,500
Scotiabank	32,000	40,000
Total	\$32,000	\$44,500

The following table summarizes the fair value of interest rate swap and cross-currency interest rate swap derivative instruments that qualify for derivative hedge accounting (in thousands, except footnote data):

	February 28, 2014		August 31, 2013	
	Balance Sheet Account	Fair Value	Balance Sheet Account	Fair Value
Derivatives designated as cash flow hedging instruments				
Cross currency interest rate swaps <sup>(1)(2)</sup>	Prepaid expenses and current assets	\$891	Prepaid expenses and current assets	\$—
Cross currency interest rate swaps <sup>(1)(2)</sup>	Other non-current assets	1,969	Other non-current assets	1,505
Interest rate swaps <sup>(3)</sup>	Other long-term liabilities	—	Other long-term liabilities	(14 )
Net fair value of derivatives designated as hedging instruments - assets (liability) <sup>(4)</sup>		\$2,860		\$1,491

The effective portion of the cross-currency interest rate swaps was recorded to Accumulated other comprehensive

<sup>(1)</sup> (income)/loss for \$(1.9) million and \$(1.0) million net of tax as of February 28, 2014 and August 31, 2013, respectively.

The Company has recorded a deferred tax liability amount with an offset to other comprehensive income - tax of

<sup>(2)</sup> \$(940,000) and \$(497,000) as of February 28, 2014 and August 31, 2013, respectively, related to asset positions of cross-currency interest rate swaps.

<sup>(3)</sup>



The effective portion of the interest rate swaps was recorded to Accumulated other comprehensive loss for \$0 and \$10,000 net of tax as of February 28, 2014 and August 31, 2013, respectively. The Company has recorded a deferred tax asset amount with an offset to other comprehensive income - tax of \$0 and \$4,000 as of February 28, 2014 and August 31, 2013, respectively. There were no interest rate swaps outstanding as of February 28, 2014.

<sup>(4)</sup> Derivatives listed on the above table were designated as cash flow hedging instruments.

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## Fair Value Instruments

The Company has entered into non-deliverable forward foreign-exchange contracts. These contracts are treated for accounting purposes as fair value contracts and do not qualify for derivative hedge accounting. The use of non-deliverable forward foreign-exchange contracts is intended to offset changes in cash flow attributable to currency exchange movements. These contracts are intended primarily to economically hedge exposure to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries whose functional currency is other than the U.S. dollar. The Company has entered into non-deliverable forward foreign exchange contracts; the open amounts as of February 28, 2014 are summarized below:

Subsidiary	Date entered into	Derivative Financial Counter-party	Derivative Financial Instruments	Notional Amount (in thousands)	Settlement Dates	Effective Periods
Colombia	February 2014	Bank of Nova Scotia	Forward foreign exchange contracts	\$8,000	March 2014	February 2014 - March 2014
Colombia	February 2014	Citibank N.A.	Forward foreign exchange contracts	\$5,000	March 2014 - April 2014	February 2014 - April 2014

For the three and six-month periods ended February 28, 2014 and 2013, the Company included in its consolidated statements of income the forward derivative (gain) or loss on the non-deliverable forward foreign-exchange contracts as follows (in thousands):

Income Statement Classification	Three Months Ended		Six Months Ended	
	February 28, 2014	February 28, 2013	February 28, 2014	February 28, 2013
Other income (expense), net	\$62	\$(160)	\$185	\$(132)

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

Derivatives designated as fair value hedging instruments	February 28, 2014		August 31, 2013	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Foreign currency forward contracts	Prepaid expenses and other current assets	\$1	Prepaid expenses and other current assets	\$—
Foreign currency forward contracts	Other accrued expenses	(55)	Other accrued expenses	—
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting		\$(54)		\$—

## NOTE 10 – UNCONSOLIDATED AFFILIATES

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

## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In 2008, the Company entered into real estate joint ventures to jointly own and operate separate commercial retail centers adjacent to warehouse clubs in Panama (Golf Park Plaza, S.A.) and Costa Rica (Plaza Alajuela, S.A.). Due to the initial nature of the joint ventures and the continued commitments for additional financing, the Company determined these joint ventures are VIEs. Since all rights and obligations are equally absorbed by both parties within each joint venture, the Company has determined that it is not the primary beneficiary of the VIEs and, therefore, has accounted for these entities under the equity method. Under the equity method, the Company's investments in unconsolidated affiliates are initially recorded as an investment in the stock of an investee at cost and are adjusted for the carrying amount of the investment to recognize the investor's share of the earnings or losses of the investee after the date of the initial investment.

On December 12, 2013, the Company entered into a lease agreement for approximately 17,976 square feet (1,670 square meters) of land with Golf Park Plaza, S.A. upon which the Company plans to construct its central offices in Panama. The lease term is for 15 years with three options to renew for five years each at the Company's discretion. The monthly lease expense is approximately \$8,800.

The table below summarizes the Company's interest in these VIEs and the Company's maximum exposure to loss as a result of its involvement with these VIEs as of February 28, 2014 (in thousands):

Entity	% Ownership	Initial Investment	Additional Contributions	Net Loss Inception to Date	Company's Variable Interest in Entity	Commitment to Future Additional Contributions <sup>(1)</sup>	Company's Maximum Exposure to Loss in Entity <sup>(2)</sup>
GolfPark Plaza, S.A.	50	% \$4,616	\$1,483	\$(77 )	\$6,022	\$1,017	\$7,039
Price Plaza Alajuela, S.A.	50	% 2,193	676	(33 )	2,836	1,346	4,182
Total		\$6,809	\$2,159	\$(110 )	\$8,858	\$2,363	\$11,221

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

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

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

	February 28, 2014	August 31, 2013
Current assets	\$2,078	\$606
Noncurrent assets	\$7,502	\$7,432
Current liabilities	\$1,016	\$999
Noncurrent liabilities	\$9	\$8

Three Months Ended February 28, 2014	2013	Six Months Ended February 28, 2014	2013
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Net income (loss)	\$—	\$(8	) \$8	\$(16	)
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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 11 – SEGMENTS

The Company and its subsidiaries are principally engaged in the operation of membership shopping warehouse clubs in 13 countries/territories that are located in Latin America and the Caribbean. In addition, the Company operates distribution centers and corporate offices in the United States. The Company's reportable segments are based on management's organization of these locations into operating segments by general geographic location, which are used by management in setting up management lines of responsibility, providing support services, and making operational decisions and assessments of financial performance. The Company's operating segments are the United States, Latin America and the Caribbean. Segment amounts are presented after converting to U.S. dollars and consolidating eliminations. Certain revenues and operating costs included in the United States segment have not been allocated, as it is impractical to do so.

The Company has made reclassifications to the consolidated statements of income recorded during fiscal year 2014 (see Note 1 - Company Overview and Basis of Presentation). These reclassifications have been made to prior fiscal year amounts to conform to the presentation in the current fiscal year. The following table summarizes the impact of these reclassifications to the amounts reported for each segment (in thousands):

Six Month Period Ended February 28, 2013	United States Operations	Latin American Operations	Caribbean Operations	Total
Operating income -as previously reported	\$ 17,464	\$ 36,300	\$ 12,455	\$ 66,219
Reclassification - Gain/(Loss) asset disposals	—	(71	) (33	) (104
Operating income-as currently reported	\$ 17,464	\$ 36,229	\$ 12,422	\$ 66,115
Twelve Month Period Ended August 31, 2013	United States Operations	Latin American Operations	Caribbean Operations	Total
Operating income -as previously reported	\$ 34,132	\$ 70,383	\$ 23,420	\$ 127,935
Reclassification - Gain/(Loss) asset disposals	—	(637	) (252	) (889
Operating income-as currently reported	\$ 34,132	\$ 69,746	\$ 23,168	\$ 127,046



## PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

	United States Operations	Latin American Operations	Caribbean Operations	Reconciling Items <sup>(1)</sup>	Total
Six Month Period Ended February 28, 2014					
Revenue from external customers	\$12,485	\$863,064	\$404,426	\$—	\$1,279,975
Intersegment revenues	514,694	—	2,619	(517,313 )	—
Depreciation and amortization	1,155	8,155	4,483	—	13,793
Operating income	21,582	37,585	12,567	—	71,734
Net income	14,245	25,954	9,511	—	49,710
Capital expenditures, net	3,139	49,294	5,663	—	58,096
Long-lived assets (other than deferred tax assets)	13,087	344,348	115,316	—	472,751
Goodwill	—	31,530	4,791	—	36,321
Total assets	57,377	558,426	218,513	—	834,316
Six Month Period Ended February 28, 2013					
Revenue from external customers	\$9,396	\$762,515	\$370,785	\$—	\$1,142,696
Intersegment revenues	444,339	—	2,378	(446,717 )	—
Depreciation and amortization	1,010				