PRICESMART INC
Form 10-Q
July 10, 2014

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

FORM 10-Q

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

For the quarterly period ended May 31, 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	33-0628530
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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

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

Yes ý No ¨

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

Yes ý No ¨

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

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

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

Yes ¨ No ý

The registrant had 30,209,596 shares of its common stock, par value $0.0001 per share, outstanding at June 30, 2014.

PRICESMART, INC.

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PriceSmart, Inc.’s (“PriceSmart” or the “Company”) unaudited consolidated balance sheet as of May 31, 2014 and the consolidated balance sheet as of August 31, 2013, the unaudited consolidated statements of income for the three and nine months ended May 31, 2014 and 2013, the unaudited consolidated statements of comprehensive income for the three and nine months ended ended May 31, 2014 and 2013, the unaudited consolidated statements of equity for the nine months ended May 31, 2014 and 2013, and the unaudited consolidated statements of cash flows for the nine months ended May 31, 2014 and 2013, are included herein. Also included herein are the notes to the unaudited consolidated financial statements.

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

	May 31, 2014 (Unaudited)	August 31, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$123,759	$121,874
Short-term restricted cash	2,356	5,984
Receivables, net of allowance for doubtful accounts of $2 and $0 as of May 31, 2014 and August 31, 2013, respectively	4,507	3,130
Merchandise inventories	230,693	217,413
Deferred tax assets – current	6,075	6,290
Prepaid expenses and other current assets (includes $378 and $0 as of May 31, 2014 and August 31, 2013, respectively, for the fair value of derivative instruments)	23,756	20,890
Total current assets	391,146	375,581
Long-term restricted cash	26,923	34,775
Property and equipment, net	396,749	338,478
Goodwill	36,176	36,364
Deferred tax assets – long term	12,862	12,871
Other non-current assets (includes $729 and $1,505 as of May 31, 2014 and August 31, 2013, respectively, for the fair value of derivative instruments)	25,734	19,866
Investment in unconsolidated affiliates	8,861	8,104
Total Assets	$898,451	$826,039
LIABILITIES AND EQUITY		
Current Liabilities:		
Accounts payable	$197,671	$199,425
Accrued salaries and benefits	18,041	17,862
Deferred membership income	17,770	16,528
Income taxes payable	6,867	8,059
Other accrued expenses	18,696	20,136
Dividends payable	10,593	—
Long-term debt, current portion	15,742	12,757
Deferred tax liability – current	189	111
Total current liabilities	285,569	274,878
Deferred tax liability – long-term	2,716	2,622
Long-term portion of deferred rent	5,116	4,440
Long-term income taxes payable, net of current portion	2,001	2,184
Long-term debt, net of current portion	78,353	60,263
Other long-term liabilities (includes $104 and $14 for the fair value of derivative instruments and $664 and $589 for the defined benefit plan as of May 31, 2014 and August 31, 2013, respectively)	768	603
Total liabilities	374,523	344,990
Equity:		
Common stock, $0.0001 par value, 45,000,000 shares authorized; 30,948,290 and 30,924,392 shares issued and 30,209,596 and 30,234,506 shares outstanding (net of treasury shares) as of May 31, 2014 and August 31, 2013, respectively	3	3

Preferred stock $0.0001 par value; 2,000,000 shares authorized; no shares issued and outstanding as of May 31, 2014 and August 31, 2013	—	—
Additional paid-in capital	395,569	390,581
Tax benefit from stock-based compensation	9,489	8,016
Accumulated other comprehensive loss	(50,323)	(41,475)
Retained earnings	193,738	143,871
Less: treasury stock at cost; 738,694 and 689,886 shares as of May 31, 2014 and August 31, 2013, respectively	(24,548)	(19,947)
Total equity	523,928	481,049
Total Liabilities and Equity	$898,451	$826,039

See accompanying notes.

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

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
Revenues:				
Net warehouse club sales	$597,885	$555,815	$1,844,746	$1,671,269
Export sales	6,577	6,224	19,062	15,620
Membership income	9,552	8,774	28,301	24,773
Other income	1,023	909	2,903	2,756
Total revenues	615,037	571,722	1,895,012	1,714,418
Operating expenses:				
Cost of goods sold:				
Net warehouse club	509,684	475,727	1,575,623	1,425,396
Export	6,246	5,907	18,110	14,728
Selling, general and administrative:				
Warehouse club operations	53,617	49,421	158,592	143,476
General and administrative	12,604	11,404	37,065	34,450
Pre-opening expenses	1,125	525	1,939	1,409
Loss/(gain) on disposal of assets	558	249	746	353
Total operating expenses	583,834	543,233	1,792,075	1,619,812
Operating income	31,203	28,489	102,937	94,606
Other income (expense):				
Interest income	202	338	576	1,078
Interest expense	(1,043)	(427)	(2,967)	(2,951)
Other income (expense), net	489	(785)	1,512	(1,051)
Total other expense	(352)	(874)	(879)	(2,924)
Income before provision for income taxes and income (loss) of unconsolidated affiliates	30,851	27,615	102,058	91,682
Provision for income taxes	(9,534)	(9,082)	(31,035)	(28,254)
Income (loss) of unconsolidated affiliates	3	6	7	(2)
Net income	$21,320	$18,539	$71,030	$63,426
Net income per share available for distribution:				
Basic net income per share	$0.70	$0.61	$2.35	$2.09
Diluted net income per share	$0.70	$0.61	$2.34	$2.09
Shares used in per share computations:				
Basic	29,784	29,683	29,733	29,634
Diluted	29,792	29,692	29,743	29,644
Dividends per share	$—	$—	$0.70	$0.60

See accompanying notes.

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

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
Net income	$21,320	$18,539	$71,030	$63,426
Other Comprehensive Income, net of tax:				
Foreign currency translation adjustments [1]	$3,929	$(2,073)	$(8,443)	$(5,083)
Defined benefit pension plan:				
Net gain (loss) arising during period	5	(2)	16	1
Total defined benefit pension plan	5	(2)	16	1
Unrealized gains/(losses) on change in fair value of interest rate swaps[2]	(1,343)	2,223	(421)	1,608
Other comprehensive income (loss)	2,591	148	(8,848)	(3,474)
Comprehensive income	$23,911	$18,687	$62,182	$59,952

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

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

See accompanying notes.

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

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Tax Benefit From Stock Based Compen-sation	Accumulated Other Compre-hensive Income(Loss)	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Total Equity
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	(3,286)	(3,286)
Issuance of restricted stock award	61	—	—	—	—	—	—	—	—
Forfeiture of restricted stock awards	(2)	—	—	—	—	—	—	—	—
Exercise of stock options	6	—	125	—	—	—	—	—	125
Stock-based compensation	—	—	4,854	1,271	—	—	—	—	6,125
Dividend paid to stockholders	—	—	—	—	—	(9,065)	—	—	(9,065)
Dividend payable to stockholders	—	—	—	—	—	(9,065)	—	—	(9,065)
Net income	—	—	—	—	—	63,426	—	—	63,426
Other comprehensive income (loss)	—	—	—	—	(3,474)	—	—	—	(3,474)
Balance at May 31, 2013	30,921	$ 3	$ 389,133	$ 7,951	$ (36,656)	$ 123,035	687	$ (19,766)	$ 463,700
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	—	—	—	—	—	—	49	(4,601)	(4,601)
Issuance of restricted stock award	20	—	—	—	—	—	—	—	—
Forfeiture of restricted stock awards	(1)	—	—	—	—	—	—	—	—
Exercise of stock options	5	—	118	—	—	—	—	—	118
Stock-based compensation	—	—	4,870	1,473	—	—	—	—	6,343
Dividend paid to stockholders	—	—	—	—	—	(10,570)	—	—	(10,570)

Dividend payable to stockholders	—	—	—	—	—	(10,593)	—	—	(10,593)
Net income	—	—	—	—	—	71,030	—	—	71,030
Other comprehensive income (loss)	—	—	—	—	(8,848)	—	—	—	(8,848)
Balance at May 31, 2014	30,948	$ 3	$ 395,569	$ 9,489	$ (50,323)	$ 193,738	739	$ (24,548)	$ 523,928

See accompanying notes.

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

	Nine Months Ended May 31,	
	2014	2013
Operating Activities:		
Net income	$71,030	$63,426
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	20,932	17,943
Allowance for doubtful accounts	6	4
Loss on sale of property and equipment	746	356
Deferred income taxes	1,869	2,143
Excess tax (benefit) on stock-based compensation	(1,473)	(1,271)
Equity in (gains)/losses of unconsolidated affiliates	(7)	2
Stock-based compensation	4,870	4,854
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	(11,246)	667
Merchandise inventories	(13,280)	(19,880)
Accounts payable	2,746	(1,308)
Net cash provided by operating activities	76,193	66,936
Investing Activities:		
Additions to property and equipment	(82,774)	(52,383)
Deposits for land purchase option agreements	(850)	—
Proceeds from disposal of property and equipment	78	70
Capital contributions to joint ventures	(750)	(550)
Net cash flows (used in) investing activities	(84,296)	(52,863)
Financing Activities:		
Proceeds from bank borrowings	37,734	3,980
Repayment of bank borrowings	(17,390)	(5,817)
Cash dividend payments	(10,570)	(9,065)
Release of restricted cash	8,000	2,000
Excess tax benefit on stock-based compensation	1,473	1,271
Purchase of treasury stock	(4,601)	(3,286)
Proceeds from exercise of stock options	118	125
Net cash (used in) financing activities	14,764	(10,792)
Effect of exchange rate changes on cash and cash equivalents	(4,776)	(2,121)
Net (decrease) increase in cash and cash equivalents	1,885	1,160
Cash and cash equivalents at beginning of period	121,874	91,248
Cash and cash equivalents at end of period	$123,759	$92,408
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest, net of amounts capitalized	$2,508	$2,012
Income taxes	$33,308	$27,733
Supplemental non-cash item:		
Dividends declared but not paid	$10,593	$9,065

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
May 31, 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 May 31, 2014, the Company had 33 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, Honduras and in the Dominican Republic, two in El Salvador 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 May of fiscal year 2014, the Company opened its third warehouse club in Honduras in Tegucigalpa. 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. In January of fiscal year 2014, the Company acquired land in the southern area of Pereira, Colombia and in the city of Medellin, Colombia and leased land in the city of Bogota, Colombia. The Company is currently constructing new warehouse clubs at these three sites and plans to open them 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. 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.

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):

Fiscal Year 2013 Three Months Ended November 30, 2012	February 28, 2013	May 31, 2013	August 31, 2013	Total Fiscal Year 2013
$(58)	$(312)	$(1,034)	$(439)	$(1,843)

Other income (expense), net – as previously reported					
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)

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

	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 May 31, 2014, all of the Company's subsidiaries were wholly owned. Additionally, the Company's ownership interest in real estate development joint ventures as of May 31, 2014 is listed below:

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

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

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

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

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

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

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

	May 31, 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	—	3,148
Restricted cash in Colombia for property purchase agreements	247	1,599
Restricted cash for land purchase option agreements	850	—
Other short-term restricted cash [(1)]	59	37
Total short-term restricted cash	$ 2,356	$ 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 [(1)]	1,203	1,055
Total long-term restricted cash	$ 26,923	$ 34,775
Total restricted cash	$ 29,279	$ 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 $4.9 million and $4.3 million as of May 31, 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):

	May 31, 2014	August 31, 2013
Prepaid expenses and other current assets	$ 4,607	$ 5,458
Other non-current assets	$ 16,726	$ 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 May 31, 2014 and August 31, 2013 is as follows (in thousands):

	May 31, 2014		August 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value

Long-term debt, including current portion	$ 94,095	$ 100,292	$ 73,020	$ 72,576

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

Derivatives Instruments and Hedging Activities - The Company uses derivative financial instruments for hedging and non-trading purposes to manage its exposure to changes in interest and currency exchange rates. In using derivative financial instruments for the purpose of hedging the Company's exposure to interest and currency exchange rate risks, the contractual terms of a hedged instrument closely mirror those of the hedged item, providing a high degree of risk reduction and correlation. Contracts that are effective at meeting the risk reduction and correlation criteria (effective hedge) are recorded using hedge accounting. If a derivative financial instrument is an effective hedge, changes in the fair value of the instrument will be offset in accumulated other comprehensive income (loss) until the hedged item completes its contractual term. If any portion of the hedge is deemed ineffective, the change in fair value of the hedged assets or liabilities will be immediately recognized in earnings during the period. Instruments that do not meet the criteria for hedge accounting, or contracts for which the Company has not elected hedge accounting, are valued at fair value with unrealized gains or losses reported in earnings during the period of the change. Valuation techniques utilized in the fair value measurement of assets and liabilities presented on the Company's consolidated balance sheets were not changed from previous practice during the reporting period.

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. If a cash flow hedge that was previously considered effective is later determined to be an ineffective hedge, 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. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of interest rate swaps and cross-currency interest rate swaps as of May 31, 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. From time to time, 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. These contracts generally 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 May 31, 2014 and August 31, 2013.

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

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 May 31, 2014 and August 31, 2013 (in thousands) for derivatives that qualify for hedge accounting:

Assets and Liabilities as of May 31, 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)	$—	$378	$—	$378
Other non-current assets - (Cross-currency interest rate swaps)	—	729	—	729
Other long-term liabilities – (Interest rate swaps)	—	(28)	—	(28)
Other long-term liabilities – (Cross-currency interest rate swaps)	—	(76)	—	(76)
Total	$—	$1,003	$—	$1,003

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 Company held no derivatives as of May 31, 2014 and August 31, 2013 that did not qualify for hedge accounting. As of May 31, 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 May 31, 2014 and August 31, 2013 (in thousands). The change in goodwill is a result of foreign exchange translation losses.

May 31, 2014	August 31, 2013	Change

Goodwill	$36,176	$36,364	$(188)

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

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

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.
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. 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Foreign Currency Translation – The assets and liabilities of the Company’s foreign operations are translated to U.S. dollars when the functional currency in the Company’s international subsidiaries is the local currency and not U.S. dollars. Assets and liabilities of these foreign subsidiaries are translated to U.S. dollars at the exchange rate on the balance sheet date, and revenue, costs and expenses are translated at average rates of exchange in effect during the period. The corresponding translation gains and losses are recorded as a component of accumulated other comprehensive income or loss. These adjustments will affect net income upon the sale or liquidation of the underlying investment. Monetary assets and liabilities denominated in currencies other than the functional currency of the respective entity (primarily U.S. Dollars) are revalued to the functional currency using the exchange rate on the balance sheet date. These foreign exchange transaction gains (losses), including transactions recorded involving these monetary assets and liabilities, are recorded as Other income (expense) in the consolidated statements of income. The following table summarizes the amounts recorded for the three and nine month periods ending May 31, 2014 and 2013 (in thousands):

	Three Months Ended		Nine Months Ended	
	May 31, 2014	May 31, 2013	May 31, 2014	May 31, 2013
Currency gain (loss)	$489	$(785)	$1,512	$(1,051)

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.

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. 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 May 31, 2014 and 2013. However, during the nine months ended May 31, 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 $2.6 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 present a reconciliation of the effective tax rate for the periods presented:

	Three Months Ended				Nine Months Ended			
	May 31, 2014		May 31, 2013		May 31, 2014		May 31, 2013	
Federal tax provision at statutory rates	35.0	%	35.0	%	35.0	%	35.0	%
State taxes, net of federal benefit	0.3		0.3		0.3		0.3	
Differences in foreign tax rates	(7.1	)	(4.3	)	(5.5	)	(4.4	)
Permanent items and other adjustments	4.5		1.7		1.2		(0.6	)
Increase (decrease) in foreign valuation allowance	(1.8	)	0.2		(0.6	)	0.5	
Provision for income taxes	30.9	%	32.9	%	30.4	%	30.8	%

The variance in the effective tax rate for the three-month period ended on May 31, 2014 compared to the same period of the prior year was primarily attributable to a 2.8% favorable impact resulting from a greater proportion of income falling into low tax jurisdictions and a favorable impact of 1.8% resulting from the reduction in valuation allowance against net deferred tax assets of the Company’s Colombia subsidiary offset by 1.7% due to permanent adjustments relating to the tax effect of foreign currency exchange gains/losses.

The variance in the effective tax rate for the first nine months of the period ended on May 31, 2014 compared to the same period of the prior year was primarily attributable to the favorable impact of 1.1% resulting from a greater proportion of income falling into low tax jurisdictions, the favorable impact of 1.1% resulting from the reduction in valuation allowance against net deferred tax assets of the Company’s Colombia subsidiary, and the offsetting impact of 0.9% due to permanent adjustments relating to the tax effect of foreign currency exchange gains/losses.

Recent Accounting Pronouncements

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

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

Step 1: Identify the contract(s) with a customer.
Step 2: Identify the performance obligations in the contract.
Step 3: Determine the transaction price.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Step 4: Allocate the transaction price to the performance obligations in the contract.
Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. This amendment is to be either retrospectively adopted to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this ASU recognized at the date of initial application. Adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

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.

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):

	May 31, 2014	August 31, 2013
Land	$123,499	$100,108
Building and improvements	243,996	228,257
Fixtures and equipment	141,579	119,242
Construction in progress	34,732	23,657
Total property and equipment, historical cost	543,806	471,264
Less: accumulated depreciation	(147,057)	(132,786)
Property and equipment, net	$396,749	$338,478

Depreciation and amortization expense (in thousands):

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
Depreciation and amortization expense	$7,139	$6,228	$20,932	$17,943

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 May 31, 2014	As of August 31, 2013
Total interest capitalized	$4,459	$4,475

Total interest capitalized (in thousands):

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
Interest capitalized	$452	$1,008	$945	$1,289

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 nine months ended May 31, 2014 and 2013 (in thousands, except per share amounts):

	Three Months Ended May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
Net income	$21,320	$18,539	$71,030	$63,426
Less: Allocation of income to unvested stockholders	(348)	(372)	(1,296)	(1,344)
Net earnings available to common stockholders	$20,972	$18,167	$69,734	$62,082
Basic weighted average shares outstanding	29,784	29,683	29,733	29,634
Add dilutive effect of stock options (two-class method)	8	9	10	10
Diluted average shares outstanding	29,792	29,692	29,743	29,644
Basic net income per share	$0.70	$0.61	$2.35	$2.09
Diluted net income per share	$0.70	$0.61	$2.34	$2.09

NOTE 5 – STOCKHOLDERS' EQUITY

Dividends

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

		First Payment				Second Payment			
Declared	Amount	Record Date	Date Paid	Date Payable	Amount	Record Date	Date Paid	Date Payable	Amount
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 May 31,					
	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 [1]	$3,929	$—	$3,929	$(2,073)	$—	$(2,073)
Defined benefit pension plans:						
Net gain (loss) arising during period	6	(1)	5	1	(3)	(2)
Total defined pension plans	6	(1)	5	1	(3)	(2)
Unrealized gains (losses) on change in fair value of interest rate swaps[2]	(1,857)	514	(1,343)	2,558	(335)	2,223
Other comprehensive income (loss)	$2,078	$513	$2,591	$486	$(338)	$148

	Nine Months Ended May 31,					
	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 [1]	$(8,443)	$—	$(8,443)	$(5,083)	$—	$(5,083)
Defined benefit pension plans:						
Net gain (loss) arising during period	18	(2)	16	2	(1)	1
Total defined pension plans	18	(2)	16	2	(1)	1
Unrealized gains (losses) on change in fair value of interest rate swaps[2]	(489)	68	(421)	1,974	(366)	1,608
Other comprehensive income (loss)	$(8,914)	$66	$(8,848)	$(3,107)	$(367)	$(3,474)

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

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

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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):

	Nine Months Ended May 31, 2014			
	Foreign currency translation adjustments	Defined benefit pension plans	Unrealized gains/(losses) on change in fair value of interest rate swaps (1)	Accumulated other comprehensive loss
Beginning balance, September 1, 2013	$(42,321)	$(152)	$998	$(41,475)
Other comprehensive income before reclassifications	(8,443)	—	—	(8,443)
Amounts reclassified from accumulated other comprehensive income	—	16	(421)	(405)
Net current-period other comprehensive income	(8,443)	16	(421)	(8,848)
Ending balance, May 31, 2014	$(50,764)	$(136)	$577	$(50,323)

	Nine Months Ended May 31, 2013			
	Foreign currency translation adjustments	Defined benefit pension plans	Unrealized gains/(losses) on change in fair value of interest rate swaps (1)	Accumulated other comprehensive loss
Beginning balance, September 1, 2012	$(31,962)	$(74)	$(1,146)	$(33,182)
Other comprehensive income before reclassifications	(5,083)	—	—	(5,083)
Amounts reclassified from accumulated other comprehensive income	—	1	1,608	1,609
Net current-period other comprehensive income	(5,083)	1	1,608	(3,474)
Ending balance, May 31, 2013	$(37,045)	$(73)	$462	$(36,656)

	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 (1)	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	2,066
Net current-period other comprehensive income	(10,359)	(78)	2,144	(8,293)

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

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

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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):

	Nine Months Ended					Twelve Months Ended		
	May 31, 2014			May 31, 2013			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)	18		(1)	2		(1)	(365	)	(1)
Total before tax	18			2			(105	)	
Tax (expense) benefit	(2	)	Statement of Income-Provision for income taxes	(1	)	Statement of Income-Provision for income taxes	27		Statement of Income-Provision for income taxes
Net of tax	$16		(1)	$1		(1)	$(78	)	(1)
Unrealized gains/(losses) on change in fair value of interest rate swaps									
Cross currency interest rate cash flow hedges	$(776	)	Balance sheet- other non-current assets	$987		Balance sheet- other non-current assets	$1,505		Balance sheet-other non-current assets
Cross currency interest rate cash flow hedges	378		Prepaid expenses and current assets	—		Prepaid expenses and current assets	—		Prepaid expenses and current assets
Interest rate cash flow hedges	(15	)	Balance sheet- other long-term liabilities	163		Balance sheet- other long-term liabilities	203		Balance sheet-other long-term liabilities
Cross currency interest rate cash flow hedges	(76	)	Balance sheet- other long-term liabilities	824		Balance sheet- other long-term liabilities	983		Balance sheet-other long-term liabilities
Total before tax	(489	)		1,974			2,691		
Tax expense	6		Balance sheet-Deferred tax	(41	)	Balance sheet-Deferred tax	(50	)	Balance sheet-Deferred tax

		assets		assets		assets
Tax expense	62	Balance sheet- Deferred tax liabilities	(325)	Balance sheet- Deferred tax liabilities	(497)	Balance sheet- Deferred tax liabilities
Net of tax	$(421)	Balance sheet- other long-term liabilities	$1,608	Balance sheet- other long-term liabilities	$2,144	Balance sheet-other long-term liabilities

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

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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):

	May 31, 2014	August 31, 2013
Retained earnings not available for distribution	$4,529	$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 available to grant	
	Shares authorized for issuance (including shares originally authorized for issuance under the prior plans)	May 31, 2014	August 31, 2013
2013 Plan	838,766	820,916	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 May 31,		Nine Months Ended May 31,	
	2014	2013	2014	2013
Options granted to directors	$27	$29	$64	$83
Restricted stock awards	1,276	1,120	4,059	4,104
Restricted stock units	246	213	747	667
Stock-based compensation expense	$1,549	$1,362	$4,870	$4,854

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

	May 31,	
	2014	2013
Remaining unrecognized compensation cost (in thousands)	$26,199	$26,552
Weighted average period of time over which this cost will be recognized (years)	6	7
Excess tax benefit (deficiency) on stock-based compensation (in thousands)	$1,473	$1,271

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:

	Nine Months Ended May 31,	
	2014	2013
Grants outstanding at beginning of period	623,424	700,893
Granted	12,325	57,866
Forfeited	(2,048)	(2,547)
Vested	(140,182)	(130,108)
Grants outstanding at end of period	493,519	626,104

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

	Nine Months Ended May 31,	
Weighted Average Grant Date Fair Value	2014	2013
Restricted stock awards and units granted	$109.18	$80.44
Restricted stock awards and units vested	$39.47	$39.06
Restricted stock awards and units forfeited	$49.37	$30.88

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):

	Nine Months Ended May 31,	
	2014	2013
Total fair market value of restricted stock awards and units vested	$ 13,222	$ 10,102

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

	Nine Months Ended May 31,	
	2014	2013
Shares repurchased	48,808	42,434
Cost of repurchase of shares (in thousands)	$ 4,601	$ 3,286

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

	Nine Months Ended May 31,	
	2014	2013
Reissued treasury shares	—	—

The following table summarizes the stock options outstanding:

	May 31, 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

Legal Proceedings

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

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

however, that the Company's future results of operations for a particular quarter or fiscal year could be impacted by changes in circumstances relating to such matters.

Taxes

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

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

In evaluating the exposure associated with various non-income tax filing positions, the Company accrues for probable and estimable exposures for non-income tax related tax contingencies. As of May 31, 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.

Other Commitments

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

Years ended May 31,	Open Locations[1]
2015	$8,720
2016	8,378
2017	9,064
2018	9,409
2019	9,230
Thereafter	93,239

Total	$138,040	(2)

(1) Operating lease obligations have been reduced by approximately $597,000 to reflect sub-lease income. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.

(2) 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 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.

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

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 May 31, 2014 the Company has approximately $25.4 million in contractual obligations for construction services not yet rendered.

The Company has entered into land purchase option agreements that have not been recorded as commitments, for which the Company has recorded within the balance sheet approximately $1.3 million in restricted cash deposits and prepaid expenses. The land purchase option agreements can be canceled at the sole option of the Company. The Company does not have a time table of when or if it will exercise these land purchase options, due to the uncertainty related to the completion of the Company's due diligence review. The Company's due diligence review includes evaluations of the legal status of the property, the zoning and permitting issues related to acquiring approval for the construction and operation of a warehouse club and any other issues related to the property itself that could render the property unsuitable or limit the property's economic viability as a warehouse club site. If the purchase option agreements are all exercised, the cash use would be approximately $31.0 million.

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

The Company contracts for distribution center services in Mexico. The contract for this distribution center's services 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 through the end of the contract term is approximately $73,000.

NOTE 8 – DEBT

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

	Total Amount of Facilities	Facilities Used Short-term Borrowings	Letters of Credit	Facilities Available	Weighted average interest rate
May 31, 2014	$35,895	$—	$398	$35,497	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 May 31,	Amount
2015	$15,742
2016	25,176
2017	15,405

2018	7,700
2019	18,600
Thereafter	11,472
Total	$94,095

On March 31, 2014, the Company's Panama subsidiary entered into a loan agreement with The Bank of Nova Scotia. The agreement establishes a credit facility of $34.0 million at a variable interest rate of 30-day LIBOR plus 3.5% for a five year term, monthly principal and interest payments, and a $17.0 million principal payment due at maturity. The facility provides a five

year renewal option upon approval of the Bank of Nova Scotia. The loan is secured by assets of the Company's Panama subsidiary. The purpose of the loan is to repay borrowings, due to MetroBank, S.A. of $3.2 million and to fund the Company's warehouse club expansion plans. During April 2014, the Company drew down $24.0 million of the $34.0 million facility and repaid the borrowings due to MetroBank, S.A. of $3.2 million.
On March 31, 2014, the Company's Panama subsidiary entered into a loan renewal agreement with The Bank of Nova Scotia renewing for an additional five years a 5.5% fixed rate loan originally entered into on August 21, 2009. The balance on the loan as of May 31, 2014 is $5.25 million and on August 21, 2014 will be $5.0 million. The renewal agreement will become effective on August 21, 2014. The renewal agreement establishes a credit facility of $5.0 million at a variable interest rate of 30-day LIBOR plus 2.5% with a floor of 5.5%, for a five year term, with monthly principal and interest payments. The facility provides a five year renewal option upon approval of the Bank of Nova Scotia.
On March 7, 2014 the Company's Honduras subsidiary entered into a loan agreement with Banco de America Central Honduras, S.A. The agreement establishes a credit facility for 286.0 million Lempiras, approximately USD $13.8 million. The loan has a variable interest rate of 12.75%, which will be reviewed semiannually. The interest rate may not be less than 12.5%. The loan is for 10 years with a 24-month grace period on principal payments, paying interest quarterly only. Thereafter, interest and principal payments are due quarterly. This loan is secured by assets of the Company's Honduras subsidiary. On March 10, 2014, the Company drew down the full amount of the LPS 286.0 million loan.

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.

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 May 31, 2014, all of the Company's interest rate swap and cross-currency interest rate swap derivative financial instruments are designated and qualify as cash flow hedges. The 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.

The following table summarizes agreements for which the Company has recorded cash flow hedge accounting transactions during the nine months ended May 31, 2014:

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Subsidiary	Date Entered into	Derivative Financial Counter-party	Derivative Financial Instruments	Initial US$ Notional Amount	Bank US$ loan Held with	Floating Leg (swap counter-party)	Fixed Rate for PSMT Subsidiary	Settlement Dates	Effective Period of swap
Panama	22-May-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	$19,800,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.98%	4th day of each month beginning on June 4, 2014.	May 5, 2014 - April 4, 2019
Panama	22-May-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	$3,970,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.98%	4th day of each month beginning on June 4, 2014	May 5, 2014 - April 4, 2019
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		