

PRICESMART INC  
Form 10-Q  
April 09, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended February 28, 2019

OR

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

For the transition period from                      to

COMMISSION FILE NUMBER 0-22793

PriceSmart, Inc.

(Exact name of registrant as specified in its charter)

Delaware                                      33-0628530  
(State or other jurisdiction of              (I.R.S. Employer  
incorporation or organization)          Identification No.)

Edgar Filing: PRICESMART INC - Form 10-Q

9740 Scranton Road, San Diego, CA 92121

(Address of principal executive offices)

(858) 404-8800

(Registrant's telephone number, including area code)

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

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller Reporting Company
	Emerging growth company

Edgar Filing: PRICESMART INC - Form 10-Q

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

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

Yes No

The registrant had 30,544,422 shares of its common stock, par value \$0.0001 per share, outstanding at March 31, 2019.

---

PRICESMART, INC.

INDEX TO FORM 10-Q

	Page
<u>PART I - FINANCIAL INFORMATION</u>	
<u>ITEM 1. FINANCIAL STATEMENTS</u>	1
<u>CONSOLIDATED BALANCE SHEETS AS OF FEBRUARY 28, 2019 (UNAUDITED) AND AUGUST 31, 2018</u>	2
<u>CONSOLIDATED STATEMENTS OF INCOME FOR THE THREE AND SIX MONTHS ENDED FEBRUARY 28, 2019 AND 2018 - UNAUDITED</u>	4
<u>CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME FOR THE THREE AND SIX MONTHS ENDED FEBRUARY 28, 2019 AND 2018 - UNAUDITED</u>	5
<u>CONSOLIDATED STATEMENTS OF EQUITY FOR THE THREE AND SIX MONTHS ENDED FEBRUARY 28, 2019 AND 2018 - UNAUDITED</u>	6
<u>CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE SIX MONTHS ENDED FEBRUARY 28, 2019 AND 2018 - UNAUDITED</u>	8
<u>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED</u>	10
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	34
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	59
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	60
<u>PART II - OTHER INFORMATION</u>	
<u>ITEM 1. LEGAL PROCEEDINGS</u>	61
<u>ITEM 1A. RISK FACTORS</u>	61
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	61
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	61
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	61
<u>ITEM 5. OTHER INFORMATION</u>	61
<u>ITEM 6. EXHIBITS</u>	62

Table of Contents

PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PriceSmart, Inc.'s ("PriceSmart," "we" or the "Company") unaudited consolidated balance sheet as of February 28, 2019 and the consolidated balance sheet as of August 31, 2018, the unaudited consolidated statements of income for the three and six months ended February 28, 2019 and 2018, the unaudited consolidated statements of comprehensive income for the three and six months ended February 28, 2019 and 2018, the unaudited consolidated statements of equity for the three and six months ended February 28, 2019 and 2018, and the unaudited consolidated statements of cash flows for the six months ended February 28, 2019 and 2018 are included herein. Also included herein are the notes to the unaudited consolidated financial statements.

Table of Contents

PRICESMART, INC.

## CONSOLIDATED BALANCE SHEETS

(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

	February 28, 2019 (Unaudited)	August 31, 2018
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 90,261	\$ 93,460
Short-term restricted cash	4,464	405
Short-term investments	23,501	32,304
Receivables, net of allowance for doubtful accounts of \$120 as of February 28, 2019 and \$97 as of August 31, 2018, respectively.	10,500	8,859
Merchandise inventories	334,899	321,025
Prepaid expenses and other current assets	35,898	31,800
Total current assets	499,523	487,853
Long-term restricted cash	3,352	3,049
Property and equipment, net	626,279	594,403
Goodwill	46,263	46,329
Other intangibles, net	13,788	14,980
Deferred tax assets	11,786	10,166
Other non-current assets (includes \$3,611 and \$4,364 as of February 28, 2019 and August 31, 2018, respectively, for the fair value of derivative instruments)	46,525	48,854
Investment in unconsolidated affiliates	10,714	10,758
Total Assets	\$ 1,258,230	\$ 1,216,392
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities:		
Accounts payable	274,311	255,739
Accrued salaries and benefits	20,219	22,836
Deferred income	24,725	23,018
Income taxes payable	3,793	4,636
Other accrued expenses	32,652	28,281
Dividends payable	10,672	—
Long-term debt, current portion	26,193	14,855
Total current liabilities	392,565	349,365
Deferred tax liability	2,078	1,894
Long-term portion of deferred rent	9,061	8,885
Long-term income taxes payable, net of current portion	5,081	4,622
Long-term debt, net of current portion	69,793	87,720
	6,062	5,268

Edgar Filing: PRICESMART INC - Form 10-Q

Other long-term liabilities (includes \$610 and \$502 for the fair value of derivative instruments and \$5,151 and \$4,715 for post-employment plans as of February 28, 2019 and August 31, 2018, respectively)

Total Liabilities	484,640	457,754
-------------------	---------	---------

Table of Contents

## Stockholders' Equity:

Common stock \$0.0001 par value, 45,000,000 shares authorized; 31,447,055 and 31,372,752 shares issued and 30,495,712 and 30,460,353 shares outstanding (net of treasury shares) as of February 28, 2019 and August 31, 2018, respectively	3	3
Additional paid-in capital	442,273	432,882
Tax benefit from stock-based compensation	11,486	11,486
Accumulated other comprehensive loss	(130,110)	(121,216)
Retained earnings	491,032	473,954
Less: treasury stock at cost, 951,343 shares as of February 28, 2019 and 912,399 shares as of August 31, 2018	(41,524)	(39,107)
Total stockholders' equity attributable to PriceSmart, Inc. stockholders	773,160	758,002
Noncontrolling interest in consolidated subsidiaries	430	636
Total stockholders' equity	773,590	758,638
Total Liabilities and Equity	\$ 1,258,230	\$ 1,216,392

See accompanying notes.



Table of Contents

PRICESMART, INC.

## CONSOLIDATED STATEMENTS OF INCOME

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

	Three Months Ended		Six Months Ended	
	February 28,	February 28,	February 28,	February 28,
	2019	2018	2019	2018
Revenues:				
Net merchandise sales	\$ 820,290	\$ 816,573	\$ 1,567,733	\$ 1,561,974
Export sales	6,844	9,138	15,033	17,285
Membership income	12,845	12,703	25,585	25,078
Other revenue and income	14,446	1,149	25,711	2,298
Total revenues	854,425	839,563	1,634,062	1,606,635
Operating expenses:				
Cost of goods sold:				
Net merchandise sales	705,546	699,355	1,346,701	1,336,591
Export sales	6,486	8,685	14,264	16,434
Non-merchandise	4,826	—	9,073	—
Selling, general and administrative:				
Warehouse club and other operations	75,708	71,951	149,930	141,453
General and administrative	24,968	20,258	52,303	39,088
Pre-opening expenses	97	81	112	511
Asset impairment	—	1,929	—	1,929
Loss/(gain) on disposal of assets	258	40	473	199
Total operating expenses	817,889	802,299	1,572,856	1,536,205
Operating income	36,536	37,264	61,206	70,430
Other income (expense):				
Interest income	423	368	814	768
Interest expense	(1,001)	(992)	(2,034)	(2,247)
Other income (expense), net	(372)	210	(2,191)	488
Total other income (expense)	(950)	(414)	(3,411)	(991)
Income before provision for income taxes and income (loss) of unconsolidated affiliates	35,586	36,850	57,795	69,439
Provision for income taxes	(11,703)	(22,707)	(19,243)	(32,822)
Income (loss) of unconsolidated affiliates	(20)	5	(44)	21
Net income	23,863	\$ 14,148	\$ 38,508	\$ 36,638
Less: net (income) loss attributable to noncontrolling interest	(53)	—	(86)	—
Net income attributable to PriceSmart, Inc.	\$ 23,810	\$ 14,148	\$ 38,422	\$ 36,638

Net income attributable to PriceSmart, Inc. per share  
available for distribution:

Basic	\$ 0.79	\$ 0.47	\$ 1.27	\$ 1.21
Diluted	\$ 0.79	\$ 0.47	\$ 1.27	\$ 1.21
Shares used in per share computations:				
Basic	30,206	30,100	30,189	30,089
Diluted	30,211	30,100	30,200	30,090
Dividends per share	\$ 0.70	\$ 0.70	\$ 0.70	\$ 0.70

See accompanying notes.

Table of Contents

PRICESMART, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Three Months Ended		Six Months Ended	
	February 28,	February 28,	February 28,	February 28,
	2019	2018	2019	2018
Net income	\$ 23,863	\$ 14,148	\$ 38,508	\$ 36,638
Less: net (income) loss attributable to noncontrolling interest	(53)	—	(86)	—
Net income attributable to PriceSmart, Inc.	\$ 23,810	\$ 14,148	\$ 38,422	\$ 36,638
Other Comprehensive Income, net of tax:				
Foreign currency translation adjustments (1)	5,121	4,339	(8,276)	2,313
Defined benefit pension plan:				
Net gain (loss) arising during period	4	—	13	—
Amortization of prior service cost and actuarial gains included in net periodic pensions cost	18	29	37	59
Total defined benefit pension plan	22	29	50	59
Derivative instruments: (2)				
Unrealized gains/(losses) on change in fair value of interest rate swaps	(791)	850	(668)	1,437
Total derivative instruments	(791)	850	(668)	1,437
Other comprehensive income (loss)	4,352	5,218	(8,894)	3,809
Comprehensive income	28,162	19,366	\$ 29,528	\$ 40,447
Less: comprehensive income/(loss) attributable to noncontrolling interest	22	—	21	—
Comprehensive income attributable to PriceSmart, Inc. to stockholders	\$ 28,140	\$ 19,366	\$ 29,507	\$ 40,447

(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 8 - Derivative Instruments and Hedging Activities.

See accompanying notes.



Table of Contents

PRICESMART, INC.

## CONSOLIDATED STATEMENTS OF EQUITY

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Three Months Ended							Total		
	Common Stock Shares	Amount	Additional Paid-in Capital	Tax Benefit From Stock Based Compensation	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Stockholder's Equity Attributable to PriceSmart, Inc.	
Balance at November 30, 2017	31,279	\$ 3	\$ 424,856	\$ 11,486	\$ (111,468)	\$ 443,356	875	\$ (35,924)	\$ 732,309	\$ -
Purchase of treasury stock	—	—	—	—	—	—	21	(1,833)	(1,833)	-
Issuance of restricted stock	35	—	—	—	—	—	—	—	—	-
Forfeiture of restricted stock awards	(7)	—	—	—	—	—	—	—	—	-
Exercise of stock options	4	—	269	—	—	—	—	—	269	-
Stock-based compensation	—	—	2,420	—	—	—	—	—	2,420	-
Dividend paid to stockholders	—	—	—	—	—	(10,645)	—	—	(10,645)	-
Dividend payable to stockholders	—	—	—	—	—	(10,652)	—	—	(10,652)	-
Net income	—	—	—	—	—	14,148	—	—	14,148	-
Other comprehensive income (loss)	—	—	—	—	5,218	—	—	—	5,218	-
Balance at February 28,	31,311	\$ 3	\$ 427,545	\$ 11,486	\$ (106,250)	\$ 436,207	896	\$ (37,757)	\$ 731,234	\$ -

Edgar Filing: PRICESMART INC - Form 10-Q

2018

Balance at November 30, 2018	31,405	\$ 3	\$ 438,928	\$ 11,486	\$ (134,462)	\$ 488,566	912	\$ (39,107)	\$ 765,414	\$ 6
Purchase of treasury stock	—	—	—	—	—	—	39	(2,417)	(2,417)	—
Issuance of restricted stock	44	—	—	—	—	—	—	—	—	—
Forfeiture of restricted stock awards	(2)	—	—	—	—	—	—	—	—	—
Exercise of stock options	—	—	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	3,345	—	—	—	—	—	3,345	—
Dividend paid to stockholders	—	—	—	—	—	(10,672)	—	—	(10,672)	(
Dividend payable to stockholders	—	—	—	—	—	(10,672)	—	—	(10,672)	(
Net income	—	—	—	—	—	23,810	—	—	23,810	5
Other comprehensive income (loss)	—	—	—	—	4,352	—	—	—	4,352	2
Balance at February 28, 2019	31,447	\$ 3	\$ 442,273	\$ 11,486	\$ (130,110)	\$ 491,032	951	\$ (41,524)	\$ 773,160	\$ 4

See accompanying notes.

6

Table of Contents

PRICESMART, INC.

## CONSOLIDATED STATEMENTS OF EQUITY

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Six Months Ended								Total	
	Common Stock	Additional Paid-in Capital	Tax Benefit From Stock Based Compensation	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Shares	Amount		
Balance at August 31, 2017	31,276	\$ 3	\$ 422,395	\$ 11,486	\$ (110,059)	\$ 420,866	875	\$ (35,924)	\$ 708,767	\$ -
Purchase of treasury stock	—	—	—	—	—	—	21	(1,833)	(1,833)	-
Issuance of restricted stock award	38	—	—	—	—	—	—	—	—	-
Forfeiture of restricted stock awards	(7)	—	—	—	—	—	—	—	—	-
Exercise of stock options	4	—	269	—	—	—	—	—	269	-
Stock-based compensation	—	—	4,881	—	—	—	—	—	4,881	-
Dividend paid to stockholders	—	—	—	—	—	(10,645)	—	—	(10,645)	-
Dividend payable to stockholders	—	—	—	—	—	(10,652)	—	—	(10,652)	-
Net income	—	—	—	—	—	36,638	—	—	36,638	-
Other comprehensive income (loss)	—	—	—	—	3,809	—	—	—	3,809	-
	31,311	\$ 3	\$ 427,545	\$ 11,486	\$ (106,250)	\$ 436,207	896	\$ (37,757)	\$ 731,234	\$ -

Edgar Filing: PRICESMART INC - Form 10-Q

Balance at  
February 28,  
2018

Balance at  
August 31,  
2018

	31,373	\$ 3	\$ 432,882	\$ 11,486	\$ (121,216)	\$ 473,954	912	\$ (39,107)	\$ 758,002	\$ 6
Purchase of treasury stock	—	—	—	—	—	—	39	(2,417)	(2,417)	—
Issuance of restricted stock award	76	—	—	—	—	—	—	—	—	—
Forfeiture of restricted stock awards	(2)	—	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	9,391	—	—	—	—	—	9,391	—
Dividend paid to stockholders	—	—	—	—	—	(10,672)	—	—	(10,672)	(
Dividend payable to stockholders	—	—	—	—	—	(10,672)	—	—	(10,672)	—
Net income	—	—	—	—	—	38,422	—	—	38,422	8
Other comprehensive income (loss)	—	—	—	—	(8,894)	—	—	—	(8,894)	2
Balance at February 28, 2019	31,447	\$ 3	\$ 442,273	\$ 11,486	\$ (130,110)	\$ 491,032	951	\$ (41,524)	\$ 773,160	\$ 4

See accompanying notes.



Table of Contents

PRICESMART, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Six Months Ended	
	February 28,	February 28,
	2019	2018
Operating Activities:		
Net income	\$ 38,508	\$ 36,638
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	27,829	24,812
Allowance for doubtful accounts	23	(7)
Asset impairment and closure costs	—	1,929
(Gain)/loss on sale of property and equipment	473	199
Deferred income taxes	(916)	6,668
Equity in (gains)/losses of unconsolidated affiliates	44	(21)
Stock-based compensation	9,391	4,881
Change in operating assets and liabilities:		
Receivables, prepaid expenses and other current assets, non-current assets, accrued salaries and benefits, deferred membership income and other accruals	(417)	5,914
Merchandise inventories	(13,874)	(3,865)
Accounts payable	15,239	(18,069)
Net cash provided by (used in) operating activities	76,300	59,079
Investing Activities:		
Additions to property and equipment	(62,655)	(46,233)
Short-term investments	(9,142)	(66,388)
Proceeds from settlements of short-term investments	17,876	7,643
Proceeds from disposal of property and equipment	104	54
Net cash provided by (used in) investing activities	(53,817)	(104,924)
Financing Activities:		
Proceeds from long-term bank borrowings	—	13,500
Repayment of long-term bank borrowings	(6,345)	(23,150)
Proceeds from short-term bank borrowings	—	57,248
Repayment of short-term bank borrowings	—	(57,248)
Cash dividend payments	(10,985)	(10,645)
Purchase of treasury stock for tax withholding on stock compensation	(2,417)	(1,833)
Proceeds from exercise of stock options	—	269
Other financing activities	(86)	—
Net cash provided by (used in) financing activities	(19,833)	(21,859)

Edgar Filing: PRICESMART INC - Form 10-Q

Effect of exchange rate changes on cash and cash equivalents and restricted cash	(1,487)	(1,142)
Net increase (decrease) in cash, cash equivalents	1,163	(68,846)
Cash, cash equivalents and restricted cash at beginning of period	96,914	165,712
Cash, cash equivalents and restricted cash at end of period	\$ 98,077	\$ 96,866
Supplemental disclosure of cash flow information:		
Dividends declared but not paid	\$ 10,672	\$ 10,652

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

	Six Months Ended	
	February 28, 2019	February 28, 2018
Cash and cash equivalents	\$ 90,261	\$ 93,387
Short-term restricted cash	4,464	365
Long-term restricted cash	\$ 3,352	\$ 3,114
Total cash, cash equivalents, and restricted cash shown in the Consolidated statements of cash flows	\$ 98,077	\$ 96,866

See accompanying notes.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

February 28, 2019

NOTE 1 – COMPANY OVERVIEW AND BASIS OF PRESENTATION

PriceSmart, Inc.'s ("PriceSmart," the "Company," or "we") business consists primarily of international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. As of February 28, 2019, the Company had 41 consolidated warehouse clubs in operation in 12 countries and one U.S. territory (seven each in Colombia and Costa Rica; five in Panama; four each in Trinidad and Dominican Republic; three each in Guatemala and Honduras, two each in El Salvador and Nicaragua; and one each in Aruba, Barbados, Jamaica, and the United States Virgin Islands), of which the Company owns 100% of the corresponding legal entities (see Note 2 - Summary of Significant Accounting Policies). In May 2018, the Company acquired land in Panama and the Dominican Republic upon which the Company is constructing two new warehouse clubs. In Panama, the site is in the city of Santiago and, upon completion, it will be the sixth warehouse club in Panama. In the Dominican Republic, the site is in the city of Santo Domingo and, upon completion, it will be the fifth warehouse club in the Dominican Republic. These warehouse clubs are currently expected to open in the spring and summer of 2019, respectively. Both of these warehouse clubs will be designed using our new small warehouse club format with sales floor square footage between 30,000 to 40,000 square feet, compared to 50,000 to 60,000 sales floor square footage within our most recent standard format warehouse club openings. In September 2018 (fiscal year 2019), the Company acquired land in San Cristobal, Guatemala, upon which the Company is constructing a standard format warehouse club. San Cristobal is expected to open in the fall of 2019 (fiscal year 2020). In November 2018 (fiscal year 2019), PriceSmart leased land within the Metropark development on the south eastern side of Panama City, Panama, upon which the Company is constructing a standard format warehouse club. The Metropark club will be the Company's seventh warehouse club in Panama and is expected to open in the fall of 2019 (fiscal year 2020). Once these new warehouse clubs are open, the Company will operate 45 warehouse clubs. The Company continues to explore and negotiate for other potential sites for future warehouse clubs in Central America, the Caribbean and Colombia.

PriceSmart is developing an expansion of its omni-channel capabilities, including through its e-commerce platform, by investing in and integrating the technology, talent and cross-border logistics infrastructure obtained as part of the acquisition of a company in March 2018, which also has a marketplace and casillero business. PriceSmart expects these investments and this integration to enhance the membership shopping experience, drive efficiencies and fuel sales growth. The marketplace and casillero business operates, directly or via agency relationships, through the Aeropost brand in 38 countries in Latin America and the Caribbean, many of which overlap with markets where PriceSmart operates its warehouse clubs.

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, 2018 (the “2018 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.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation – The interim consolidated financial statements of the Company included herein include the assets, liabilities and results of operations of the Company’s wholly owned subsidiaries, subsidiaries in which it has a controlling interest, and the Company’s joint ventures for which the Company has determined that it is the primary beneficiary. The Company reports noncontrolling interests in consolidated entities as a component of equity separate from the Company’s equity. The Company’s net income excludes income attributable to its noncontrolling interests. Additionally, the consolidated financial statements also include 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 year.

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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

parties to determine whether its variable interests will absorb a majority of a VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. The reporting entity that consolidates a VIE is called the primary beneficiary of that VIE. If the Company determines that it is not the primary beneficiary of the VIE, then the Company records its investment in, and the Company's share of the income (loss) of, joint ventures recorded under the equity method. Due to the nature of the joint ventures that the Company participates in and the continued commitments for additional financing, the Company determined these joint ventures are VIEs.

The Company has determined that for its ownership interest in store-front joint ventures within its marketplace and casillero business, the Company has the power to direct the activities that most significantly impact the economic performance of these VIE's. Therefore, the Company has determined that it is the primary beneficiary of these VIEs and has consolidated these entities within its consolidated financial statements. The Company's ownership interest in these store-front joint ventures, for which the Company has consolidated their financial statements as of February 28, 2019 are listed below:

Marketplace and Casillero Store-front Joint Ventures	Countries	Ownership	Basis of Presentation
El Salvador	EL Salvador	60.0 %	Consolidated
Guatemala	Guatemala	60.0 %	Consolidated
Tortola	British Virgin Islands	50.0 %	Consolidated
Trinidad	Trinidad	50.0 %	Consolidated

For the Company's ownership interest in real estate development joint ventures, since all rights, obligations and the power to direct the activities of a VIE that most significantly impact the VIE's economic performance is shared equally by both parties within each joint venture, the Company has determined that it is not the primary beneficiary of the VIEs and, therefore, has accounted for these entities under the equity method. Under the equity method, the Company's investments in unconsolidated affiliates are initially recorded as an investment in the stock of an investee at cost and are adjusted for the carrying amount of the investment to recognize the investor's share of the earnings or losses of the investee after the date of the initial investment. The Company's ownership interest in real estate development joint ventures for which the Company has recorded under the equity method as of February 28, 2019 are 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.

Cash and Cash Equivalents – The Company considers as cash and cash equivalents all cash on deposit, highly liquid investments with a maturity of three months or less at the date of purchase, and proceeds due from credit and debit card transactions in the process of settlement.

Table of Contents

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):

	February 28, 2019	August 31, 2018
Short-term restricted cash:		
Restricted cash for land purchase option agreements	\$ 4,460	\$ 400
Other short-term restricted cash	4	5
Total short-term restricted cash	\$ 4,464	\$ 405
Long-term restricted cash:		
Other long-term restricted cash (1)	\$ 3,352	\$ 3,049
Total long-term restricted cash	\$ 3,352	\$ 3,049
Total restricted cash	\$ 7,816	\$ 3,454

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

Short-Term Investments –The Company considers as short-term investments certificates of deposit and similar time-based deposits with financial institutions with maturities over three months and up to one year.

Goodwill and Other Intangibles – Goodwill and other intangibles totaled \$60.1 million as of February 28, 2019 and \$61.3 million as of August 31, 2018. The Company reviews reported goodwill and other intangibles at the cash-generating unit level for impairment. The Company tests Goodwill for impairment at least annually or when events or changes in circumstances indicate that it is more likely than not that the asset is impaired.

Tax Receivables – The Company pays Value Added Tax (“VAT”) or similar taxes (“input VAT”), income taxes, and other taxes within the normal course of the Company’s business in most of the countries in which the Company operates related to the procurement of merchandise and/or services it acquires and/or on sales and taxable income. The Company also collects VAT or similar taxes on behalf of the government (“output VAT”) for merchandise and/or services it sells. If the output VAT exceeds the input VAT, then the difference is remitted to the government, usually



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

In most countries where the Company operates, the VAT refund process is defined and structured with regular refunds or offsets. However, the Company, together with its tax and legal advisers, is currently seeking clarification in court in one country without a clearly defined process and expects to prevail. The balance of the VAT receivable in the country with undefined refund mechanisms was approximately \$3.8 million and \$3.1 million as of February 28, 2019 and August 31, 2018, respectively. In another country in which the Company has warehouse clubs, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires the Company to pay taxes based on a percentage of sales rather than income. As a result, the Company is making income tax payments substantially in excess of those it would expect to pay based on taxable income. The rules (which the Company has challenged in court) effective for fiscal years 2015 to 2018 do not clearly allow us to obtain a refund or offset this excess income tax against other taxes. As of February 28, 2019, the Company had deferred tax assets of approximately \$2.2 million in this country. Also, the Company had an income tax receivable balance of \$7.0 million as of February 28, 2019 related to excess payments from fiscal years 2015 to 2019. In the third quarter of fiscal year 2018, a revised minimum tax law was passed in this country, which beginning in fiscal year 2020 will reduce the minimum tax rate. Additionally, this law clarifies rules on a go-forward basis for reimbursement of excess minimum tax paid beginning in fiscal year 2019, but does not address periods prior to fiscal year 2019. Nevertheless, the Company has not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets because the Company believes that it is more likely than not that it will ultimately succeed in its refund requests, related appeals and/or court challenge on these matters.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

- Short-term VAT and Income tax receivables, recorded as Other current assets: This classification is used for any countries where the Company's subsidiary has generally demonstrated the ability to recover the VAT or income tax receivable within one year. The Company also classifies as short-term any approved refunds or credit notes to the extent that the Company expects to receive the refund or use the credit notes within one year.
- Long-term VAT and Income tax receivables, recorded as Other non-current assets: This classification is used for amounts not approved for refund or credit in countries where the Company's subsidiary has not demonstrated the ability to obtain refunds within one year and/or for amounts which are subject to outstanding disputes. An allowance is provided against VAT and income tax receivable balances in dispute when the Company does not expect to eventually prevail in its recovery. The Company does not currently have any allowances provided against VAT and income tax receivables.

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

	February 28, 2019	August 31, 2018
Prepaid expenses and other current assets	\$ 5,187	\$ 5,921
Other non-current assets	20,765	19,224
Total amount of VAT receivables reported	\$ 25,952	\$ 25,145

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

February 28,    August 31,

Edgar Filing: PRICESMART INC - Form 10-Q

	2019	2018
Prepaid expenses and other current assets	\$ 9,616	\$ 6,344
Other non-current assets	15,325	18,165
Total amount of Income tax receivables reported	\$ 24,941	\$ 24,509

Lease Accounting – Certain of the Company's operating leases where the Company is the lessee provide for minimum annual payments that increase over the 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 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.

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 lease term. The Company also accounts in its straight-line computation for the effect of any "rental holidays."

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

Stock Based Compensation – The Company utilizes three types of equity awards: restricted stock awards (“RSAs”), restricted stock units (“RSUs”) and performance based restricted stock units (“PSUs”). Compensation related to RSAs, RSUs and PSUs is based on the fair market value at the time of grant. The Company recognizes the compensation cost related to RSAs and RSUs 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 also recognizes compensation cost for PSUs over the performance period. The Company assesses

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

the probability of vesting for awards with performance conditions and adjusts compensation cost based on the probability that performance metrics will be achieved. If the Company determines that an award is unlikely to vest, any previously recorded expense is then reversed.

The Company accounts for actual forfeitures as they occur. The Company records the tax savings resulting from tax deductions in excess of expense for stock-based compensation and the tax deficiency resulting from stock-based compensation in excess of the related tax deduction as income tax expense or benefit. In addition, the Company reflects the tax savings (deficiency) resulting from the taxation of stock-based compensation as an operating cash flow in its consolidated statement of cash flows.

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

PSUs, similar to RSUs, are awarded with dividend equivalents, provided that such amounts become payable only if the performance metric is achieved. At the time the Compensation Committee confirms the performance metric has been achieved, the accrued dividend equivalents are paid on the PSUs.

In October 2018, the Company's then Chief Executive Officer ("former C.E.O."), resigned by mutual agreement with the Board of Directors. In connection with his departure, the Company recognized a one-time separation charge of approximately \$3.8 million (\$3.6 million net of tax) in the first quarter of fiscal year 2019. This amount was comprised of approximately \$2.9 million of non-cash charges related to the acceleration of certain equity awards and approximately \$892,000 for other separation costs. Given that the former C.E.O. had substantially rendered the required services per his separation agreement, the Company recorded these charges in the first quarter of fiscal 2019. This charge was recorded in the General and administrative caption within the Consolidated Statements of Income and is recorded in the Company's United States segment. The Company will substantially fulfill all payment obligations by the end of the second quarter of fiscal year 2020.

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, consisted of cash flow hedges (interest rate swaps and cross-currency interest rate swaps) and forward foreign exchange contracts. In addition, the Company utilizes Level 2 inputs in determining the fair value of long-term debt. The Company did not make any significant transfers in and out of Level 1 and Level 2 fair value tiers during the periods reported on herein.

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

The Company's current and long-term financial assets and liabilities have fair values that approximate their carrying values. The Company's long-term financial liabilities consist of long-term debt, which is recorded on the balance sheet at issuance price and adjusted for any applicable unamortized discounts or premiums and debt issuance costs. There have been no significant changes in fair market value of the Company's current and long-term financial assets, and there have been no material changes to the valuation techniques utilized in the fair value measurement of assets and liabilities as disclosed in the Company's 2018 Form 10-K.

Derivatives Instruments and Hedging Activities – The Company uses derivative financial instruments for hedging and non-trading purposes to manage its exposure to changes in interest and currency exchange rates. In using derivative financial

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

**Cash Flow Instruments.** The Company is a party to receive floating interest rate, pay fixed-rate interest rate swaps to hedge the interest rate risk of certain U.S. dollar denominated debt within its international subsidiaries. The swaps are designated as cash flow hedges of interest expense risk. These instruments are considered effective hedges and are recorded using hedge accounting. The Company is also a party to receive variable interest rate, pay fixed interest rate cross-currency interest rate swaps to hedge the interest rate and currency exposure associated with the expected payments of principal and interest of U.S. denominated debt within its international subsidiaries whose functional currency is other than the U.S. dollar. The swaps are designated as cash flow hedges of the currency risk and interest-rate risk related to payments on the U.S. denominated debt. These instruments are also considered to be effective hedges and are recorded using hedge accounting. Under cash flow hedging, the entire gain or loss of the derivative, calculated as the net present value of the future cash flows, is reported on the consolidated balance sheets in accumulated other comprehensive loss. Amounts recorded in accumulated other comprehensive loss are released to earnings in the same period that the hedged transaction impacts consolidated earnings. See Note 8 - Derivative Instruments and Hedging Activities for information on the fair value of interest rate swaps and cross-currency interest rate swaps as of February 28, 2019 and August 31, 2018.

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

does not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features and are limited to less than one year in duration.

**Self-Insurance** – As of October 1, 2017, PriceSmart, Inc. became self-insured for its U.S. employee medical health benefits and in doing so the Company has assumed the financial risk for providing health care benefits to its employees. The Company contracted with Cigna Health and Life Insurance Company (“CHLIC”), a third party administrator, to process claims on its behalf under an Administrative Services Only (ASO) agreement. The Company has elected to purchase “Stop Loss Insurance” to cover the risk in excess of certain dollar limits. The Company establishes an estimated accrual for its insurance program based on available comparable claims data, trends and projected ultimate costs of claims. This accrual is based on estimates prepared with the assistance of outside actuaries, and the ultimate cost of these claims may vary from initial estimates and established accrual. The actuaries periodically update their estimates, and the Company records such adjustments in the period in which such determination is made. The accrued obligation for this self-insurance program is included in “Accrued salaries and benefits” in the consolidated balance sheets and is \$681,000 as of February 28, 2019 and \$801,000 as of August 31, 2018.

**Cost of Goods Sold** – The Company includes the cost of merchandise, food service and bakery raw materials in cost of goods sold, net merchandise sales. The Company also includes in cost of goods sold: net merchandise sales 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 and building and equipment depreciation at the Company's distribution facilities and payroll and other direct costs for in-store demonstrations.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

For export sales, the Company includes the cost of merchandise and external and internal distribution and handling costs for supplying merchandise in cost of goods sold, exports.

For the marketplace and casillero operations, the Company includes the costs of external and internal shipping, handling and other direct costs incurred to provide delivery, insurance and customs processing services in cost of goods sold, non-merchandise.

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

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

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

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 material 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.

The following table discloses the net effect of translation into the reporting currency on other comprehensive income (loss) for these local currency denominated accounts for the three and six months ended February 28, 2019 and 2018:

	Three Months		Six Months Ended	
	Ended	February	February	February 28,
	28,	28,	28,	February 28,
	2019	2018	2019	2018
Effect on other comprehensive (loss) income due to foreign currency translation	\$ 5,121	\$ 4,339	\$ (8,276)	\$ 2,313

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.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

For the three and six months ended February 28, 2019, we had a net expense associated with foreign currency transactions of approximately \$368,000 and \$2.1 million respectively.

Recent Accounting Pronouncements – Not Yet Adopted

FASB ASC 815 ASU 2018-16 – Derivatives and Hedging — Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes

In October 2018, the Financial Accounting Standards Board “FASB” issued Accounting Standards Update (ASU) No. 2018-16, Derivatives and Hedging—Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes, which expands the list of United States benchmark interest rates permitted in the application of hedge accounting. The amendments in this ASU allow use of the Overnight Index Swap (OIS) rate based on the Secured Overnight Financing Rate (SOFR) as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, Derivatives and Hedging. The amendments in this ASU are effective for annual periods beginning after December 15, 2018 and interim periods within those annual periods. The Company will evaluate the impact adoption of this guidance may have on the Company’s consolidated financial statements.

FASB ASC 810 ASU 2018-15 – Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract

In August 2018, the FASB issued ASU No. 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s accounting for implementation costs incurred in a cloud computing arrangement that is a service contract. ASU No. 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). As such, the amendment in this ASU requires an entity (customer) in a hosting arrangement that is a service contract to follow the guidance in subtopic 350-40 in order to determine which implementation costs to capitalize as an asset and which costs to expense.

Additionally, the amendments in this ASU require the entity to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. The amendments in this ASU are effective for annual periods beginning after December 15, 2019 and interim periods within those annual periods. Early adoption is permitted. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

#### FASB ASC 718 ASU 2018-07 - Compensation—Stock Compensation (Topic 718) — Improvements to Nonemployee Share-Based Payment Accounting

In June 2018, the FASB issued ASU No. 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which expands the scope to include share-based payment transactions for acquiring goods and services from non-employees. The amendments in this ASU apply to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in the grantor's own operations by issuing share-based payment awards. The amendments in this ASU are effective for annual periods beginning after December 15, 2018 and interim periods within those annual periods. Early adoption is permitted. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

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

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

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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

In February 2016, the FASB issued guidance codified in ASC 842, Leases, which supersedes the guidance in ASC 840, Leases. ASC 842 will be effective for the Company on September 1, 2019, and the Company expects to apply the transition practical expedients allowed by the standard. Note 6 – “Commitments and Contingencies” provides details on the Company’s current lease arrangements.

In July 2018, the FASB issued ASU No. 2018-11, “Leases (Topic 842): Targeted Improvements,” which provided an additional transition option that allows companies to continue applying the guidance under the current lease standard in the comparative periods presented in the consolidated financial statements. Companies that elect this option would record a cumulative-effect adjustment to the opening balance of retained earnings on the date of adoption.

In December 2018, the FASB issued ASU No. 2018-20, “Leases (Topic 842): Narrow-Scope Improvements for Lessors,” which provided clarification for lessors on how to apply the new leases standard when accounting for sales taxes, certain lessor costs, and certain requirements related to variable payments in contracts.

In March 2019, the FASB issued ASU No. 2019-01 “Leases (Topic 842): Codification Improvements,” which aligned the new leases guidance with existing guidance for fair value of the underlying asset by lessors that are not manufacturers or dealers. It also clarified an exemption for lessors and lessees from a certain interim disclosure requirement associated with adopting the board’s new lease accounting standard.

While the Company continues to evaluate the provisions of ASC 842, we currently expect the adoption of this guidance to have a material impact on the Company's consolidated balance sheets due to the creation of lease liabilities with corresponding right-of-use assets, resulting in a significant increase in the assets and liabilities on the consolidated balance sheet upon adoption. However, the Company does not expect a material change to its net income attributable to the company on its consolidated statement of income or on the net increase (decrease) in cash, cash equivalents as reported on its consolidated statement of cash flows.

Recent Accounting Pronouncements Adopted

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

In May 2017, the FASB issued ASU No. 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting, which seeks to provide clarity, reduce diversity in practice, and reduce cost and complexity when applying the guidance in Topic 718, Compensation—Stock Compensation, regarding a change to the terms or conditions of a share-based payment award. This ASU provides guidance concerning which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. Specifically, an entity is to account for the effects of a modification unless all of the following are satisfied: (1) the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified; (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3) the classification of the modified award as an equity instrument or as a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments in this ASU are effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. Early adoption is permitted. The Company adopted this guidance, prospectively, as of September 1, 2018.

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

In March 2017, the FASB issued ASU No. 2017-07, Compensation—Retirement Benefits (Topic 715) — Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This ASU is designed to improve guidance related to the presentation of defined benefit costs in the income statement. In particular, ASU 2017-07 requires that an employer report the service cost component in the same line item(s) as other compensation costs arising from services rendered by the pertinent employees during the period. The amendments in this ASU are effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. Early adoption is permitted. The Company adopted this ASU retrospectively, beginning September 1, 2018, and elected to use the practical expedient as the estimation basis for applying the retrospective presentation requirements. The service cost component of the Company's pension and postretirement expenses is reported in the Warehouse club and other operations financial statement line item. The other components of pension and post-retirement expenses are classified in Other income (expense), net. Adoption of this guidance did not have a material impact on the Company's financial statements.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

In May 2014, the FASB issued guidance on the recognition of revenue from contracts with customers. The guidance converges the requirements for reporting revenue and requires disclosures sufficient to describe the nature, amount, timing, and uncertainty of revenue and cash flows. The new standard is effective for fiscal years and interim periods within those years beginning after December 15, 2017. The Company adopted this guidance at the beginning of its first quarter of fiscal year 2019, using the modified retrospective approach through a cumulative effect adjustment to retained earnings. The Company adopted this guidance as of September 1, 2018 and has disclosed the impact adoption that this guidance had for the Company's consolidated financial statements with Note 3 – Revenue Recognition.

NOTE 3 – REVENUE RECOGNITION

Revenue Recognition – In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. The Company adopted the ASU on September 1, 2018, using the modified retrospective approach. The Company's updated accounting policies and related disclosures are set forth below, including the disclosure for disaggregated revenue. The impact of adopting the ASU was not material to the Condensed Consolidated Financial Statements.

The Company uses the five-step model to recognize revenue:

- Identify the contract with the customer;
- Identify the performance obligation(s);
- Determine the transaction price;
- Allocate the transaction price to each performance obligation if multiple obligations exist; and
- Recognize the revenue as the performance obligations are satisfied.

Performance Obligations

**Merchandise Sales.** The Company recognizes merchandise sales revenue, net of sales taxes, on transactions where the Company has determined that it is the principal in the sale of merchandise. These transactions costs may include shipping commitments and/or shipping revenue if the transaction involves delivery to the customer.

**Non-merchandise Sales.** The Company recognizes non-merchandise revenue, net of sales taxes, on transactions where the Company has determined that it is the agent in the transaction. These transactions primarily consist of contracts the Company enters into with its customers to provide delivery, insurance and customs processing services for products its customers purchase online in the United States either directly from other vendors utilizing the vendor's website or through the Company's marketplace site. Revenue is recognized when the Company's performance obligations have been completed (that is when delivery of the items have been made to the destination point) and is recorded in "non-merchandise revenue" on the Consolidated Statements of Income. Prepayment of orders for which the Company has not fulfilled its performance obligation are recorded as unearned revenue. Additionally, the Company records revenue at the net amounts retained, i.e., the amount paid by the customer less amounts remitted to the respective merchandise vendors, as the Company is acting as an agent and is not the principal in the sale of those goods being purchased from the vendors by the Company's customers.

**Membership Fee Revenue.** 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. Membership fee revenue is included in membership income in the Company's Consolidated Statements of Income. The deferred membership fee is included in deferred income in the Company's Condensed Consolidated Balance Sheets.

**Platinum Points Reward Programs.** The Company began offering Platinum memberships in Costa Rica during fiscal year 2013 and expanded this offering into Panama, Dominican Republic, Trinidad, the United States Virgin Islands and Honduras during fiscal years 2018 and 2019. The Company plans to offer this program to additional markets during fiscal year 2019. The annual fee for a Platinum membership in most markets is approximately \$75. The Platinum membership provides members with a 2% rebate on most items, up to an annual maximum of \$500. The rebate is issued annually to Platinum members on March 1 and expires August 31. Platinum members can apply this rebate to future purchases at the warehouse club during the redemption 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, platinum rewards. The Company periodically reviews expired unused rebates outstanding, and the expired unused rebates are recognized as "Other revenue and

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

income” on the consolidated statements of income. The Company has determined that breakage revenue is 5% of the awards issued; therefore, it records 95% of the Platinum membership liability at the time of sale.

**Co-branded Credit Card Points Reward Programs.** Most of the Company’s subsidiaries have points reward programs related to Co-branded Credit Cards. These points reward programs provide incremental points that can be used at a future time to acquire merchandise within the Company’s warehouse club. This results in two performance obligations, the first performance obligation being the initial sale of the merchandise or services purchased with the co-branded credit card and the second performance obligation being the future use of the points rewards to purchase merchandise or services. As a result, upon the initial sale, the Company allocates the transaction price to each performance obligation with the amount allocated to the future use points rewards recorded as a contract liability within other accrued expenses on the consolidated balance sheet. The portion of the selling price allocated to the reward points is recognized as Net merchandise sales when the points are used or when the points expire. The Company reviews on an annual basis expired points rewards outstanding, and the expired rewards are recognized as Net merchandise sales on the consolidated statements of income within markets where the co-branded credit card agreement allows for such treatment.

**Gift Cards.** Members’ purchases of gift cards, to be utilized at the Company’s warehouse clubs are not recognized as sales until the card is redeemed and the customer purchases merchandise using the gift card. The outstanding gift cards are reflected as other accrued expenses, gift cards in the consolidated balance sheets. These gift certificates generally have a one-year stated expiration date from the date of issuance and are generally redeemed within the 12-months. However, the absence of a large volume of transactions for gift cards 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 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 “Other revenue and income” on the consolidated statements of income.

**Co-branded Credit Card Revenue Sharing Agreements.** As part of the co-branded credit card agreements that the Company has entered into with financial institutions within its markets, the Company often enters into revenue sharing agreements. As part of these agreements, in some countries, the Company receives a portion of the interest income generated from the average outstanding balances on the co-branded credit cards from these financial institutions (“interest generating portfolio,” “IGP”). The Company recognizes its portion of interest received as revenue. As a result of the adoption of ASC 606, the Company has determined that this revenue should be recognized as “Other revenue and income” on the consolidated statements of income. In prior periods, this income was recognized as a reduction of credit card transaction fees in “Warehouse club and other operations” financial statement line item under Selling, general, and administrative expenses. Since the Company determined to adopt this guidance under the modified retrospective approach, this reclassification slightly reduces the comparability year over year of “Other revenue and income” and “Warehouse club and other operations.” Please see “Item 2: Management and Discussion



Analysis – Other Revenue” for the Company’s explanation of the changes.

#### Determining the Transaction Price

The transaction price is the amount of consideration the Company expects to receive under the arrangement. The Company is required to estimate variable consideration (if any) and to factor that estimate into the determination of the transaction price. The Company may offer sales incentives to customers, including discounts. For retail transactions, the Company has significant experience with returns and refund patterns and relied on this experience in its determination that expected returns are not material; therefore, returns are not factored when determining the transaction price.

Discounts given to customers are usually in the form of coupons and instant markdowns and are recognized as redeemed and recorded in contra revenue accounts, as they are part of the transaction price of the merchandise sale. Manufacturer coupons that are available for redemption at all retailers are not recorded as a reduction to the sale price of merchandise. Manufacturer coupons or discounts that are specific to the Company are recorded as a reduction to the cost of sales.

#### Agent Relationships

The Company evaluates the criteria outlined in ASC 606-10-55, Principal versus Agent Considerations, in determining whether it is appropriate in these arrangements to record the gross amount of merchandise sales and related costs, or the net amount earned as commissions. When the Company is considered the principal in a transaction, revenue is recorded gross; otherwise, revenue is recorded on a net basis. The Company's Non-merchandise Sales revenues are recorded on a net basis.

#### Significant Judgments

For arrangements that contain multiple performance obligations, the Company allocates the transaction price to each performance obligation on a relative standalone selling price basis.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Incremental costs to obtain contracts are not material to the Company.

Policy Elections

In addition to those previously disclosed, the Company has made the following accounting policy elections and practical expedients:

- Taxes - The Company excludes from the transaction price any taxes collected from customers that are remitted to taxing authorities.
- Shipping and Handling Charges - Charges that are incurred after the customer obtains control of goods are deemed to be fulfillment costs. Therefore, the act of shipping after the customer obtains control of goods is not a separate performance obligation. Fulfillment costs are classified as “Costs of goods sold” in the consolidated statements of income because they are incurred to fulfill a revenue obligation.
- Time Value of Money - The Company's payment terms are less than one year from the transfer of goods. Therefore, the Company does not adjust promised amounts of consideration for the effects of the time value of money.

Contract Performance Liabilities

Contract performance liabilities as a result of transactions with customers primarily consist of deferred membership income, other deferred income, deferred gift card revenue, Platinum points programs, and liabilities related to co-branded credit card points rewards programs which are included in deferred income and other accrued expenses in the Company's Condensed Consolidated Balance Sheets. The following table provides these contract balances from transactions with customers as of the dates listed (in thousands):

Contract Liabilities	
February	August
28,	31,

Edgar Filing: PRICESMART INC - Form 10-Q

	2019	2018
Deferred membership income	\$ 24,660	\$ 22,996
Other contract performance liabilities	\$ 4,851	\$ 2,773

Disaggregated Revenues

In the following table, net merchandise sales are disaggregated by merchandise category (in thousands):

	Three Months Ended February 28,		Six Months Ended	
	2019	February 28, 2018	February 28, 2019	February 28, 2018
Foods & Sundries	\$ 412,857	\$ 409,311	\$ 789,185	\$ 786,382
Fresh Foods	220,499	218,332	421,205	413,088
Hardlines	98,947	102,901	191,101	199,902
Softlines	47,975	46,245	88,364	85,182
Other Business	40,012	39,784	77,878	77,420
Net Merchandise Sales	\$ 820,290	\$ 816,573	\$ 1,567,733	\$ 1,561,974

H

NOTE 4 – EARNINGS PER SHARE

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

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table sets forth the computation of net income per share for the three and six months ended February 28, 2019 and 2018 (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	February 28, 2019	February 28, 2018	February 28, 2019	February 28, 2018
Net income attributable to PriceSmart, Inc.	\$ 23,810	\$ 14,148	\$ 38,422	\$ 36,638
Less: Allocation of income to unvested stockholders	(27)	—	(219)	(398)
Net income attributable to PriceSmart, Inc. per share available for distribution:	\$ 23,783	\$ 14,148	\$ 38,203	\$ 36,240
Basic weighted average shares outstanding	30,206	30,100	30,189	30,089
Add dilutive effect of performance stock units (two-class method)	5	—	11	1
Diluted average shares outstanding	30,211	30,100	30,200	30,090
Basic net income per share	\$ 0.79	\$ 0.47	\$ 1.27	\$ 1.21
Diluted net income per share	\$ 0.79	\$ 0.47	\$ 1.27	\$ 1.21

## NOTE 5 – STOCKHOLDERS' EQUITY

## Dividends

The following table summarizes the dividends declared and paid during fiscal year 2019 and 2018 (amounts are per share).

Edgar Filing: PRICESMART INC - Form 10-Q

Declared	Amount	First Payment			Second Payment			Date Payable	Amount
		Record Date	Date Paid	Date Payable	Record Date	Date Paid	Date Payable		
1/30/2019	\$ 0.70	2/15/2019	2/28/2019	N/A	\$ 0.35	8/15/2019	N/A	8/30/2019	\$ 0.35
1/24/2018	\$ 0.70	2/14/2018	2/28/2018	N/A	\$ 0.35	8/15/2018	8/31/2018	N/A	\$ 0.35

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

Comprehensive Income and Accumulated Other Comprehensive Loss

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

	Attributable to PriceSmart	Noncontrolling Interests	Total
Beginning balance, September 1, 2018	\$ (121,216)	\$ (1)	\$ (121,217)
Foreign currency translation adjustments	(8,276)	21	(8,255)
Defined benefit pension plans	50	—	50
Derivative instruments (1)	(668)	—	(668)
Ending balance, February 28, 2019	\$ (130,110)	\$ 20	\$ (130,090)

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Attributable to PriceSmart	Noncontrolling Interests	Total
Beginning balance, September 1, 2017	\$ (110,059)	\$ —	\$ (110,059)
Foreign currency translation adjustments	2,313	—	2,313
Defined benefit pension plans	59	—	59
Derivative Instruments (1)	1,437	—	1,437
Ending balance, February 28, 2018	\$ (106,250)	\$ —	\$ (106,250)

	Attributable to PriceSmart	Noncontrolling Interests	Total
Beginning balance, September 1, 2017	\$ (110,059)	\$ —	\$ (110,059)
Foreign currency translation adjustments	(12,890)	(1)	(12,891)
Defined benefit pension plans	(87)	—	(87)
Derivative Instruments (1)	1,779	—	1,779
Amounts reclassified from accumulated other comprehensive income (loss) (2)	41	—	41
Ending balance, August 31, 2018	\$ (121,216)	\$ (1)	\$ (121,217)

(1) See Note 8 - Derivative Instruments and Hedging Activities.

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

## Retained Earnings Not Available for Distribution

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

	February 28, 2019	August 31, 2018
Retained earnings not available for distribution	\$ 6,955	\$ 6,798

## NOTE 6 – COMMITMENTS AND CONTINGENCIES

### Legal Proceedings

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

### Taxes

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



Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 has historically applied foreign tax credits, generated from taxes withheld on certain payments PriceSmart receives from its foreign subsidiaries, to reduce U.S. income tax liabilities. However, as an incidental result of U.S. tax reform, following the reduction of the U.S. corporate income tax rate from 35% to 21%, the Company expects foreign tax credits generated to exceed U.S. income tax liabilities for the foreseeable future. Therefore, as of February 28, 2019, the Company has recorded a valuation allowance of \$1.0 million against its foreign tax credits.

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

The Company accrues an amount for its estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained. There were no significant changes in the Company's uncertain income tax positions since August 31, 2018.

In evaluating the exposure associated with various non-income tax filing positions, the Company accrues for probable and estimable exposures for non-income tax related tax contingencies. As of February 28, 2019 and August 31, 2018, the Company has recorded within other accrued expenses a total of \$3.1 million and 3.0 million, respectively, for various non-income tax related tax contingencies.

While the Company believes the recorded liabilities are adequate, there are inherent limitations in projecting the outcome of litigation, in estimating probable additional income tax liability taking into account uncertain tax positions and in evaluating the probable additional tax associated with various non-income tax filing positions. As such, the

Company is unable to make a reasonable estimate of the sensitivity to change of estimates affecting its recorded liabilities. As additional information becomes available, the Company assesses the potential liability and revises its estimates as appropriate.

The Company has various appeals pending before tax courts in its subsidiaries' jurisdictions. Any possible settlement could increase or decrease earnings but is not expected to be significant. Audit outcomes and the timing of audit settlements are subject to significant uncertainty. One of the Company's subsidiaries received assessments claiming \$2.5 million of taxes, penalties and interest related to withholding taxes on certain charges for services rendered by the Company. In addition, this subsidiary received assessments totaling \$5.5 million for lack of deductibility of the underlying service charges due to the lack of withholding. Based on a review of the Company's tax advisers' interpretation of local law, rulings and jurisprudence (including Supreme Court precedents with respect to the deductibility assessment), the Company expects to prevail in both instances and has not recorded a provision for these assessments. However, the Company had to submit \$2.5 million as advance payments to the government while it appeals.

In another country in which the Company has warehouse clubs, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires the Company to pay taxes based on a percentage of sales rather than income. As a result, the Company is making income tax payments substantially in excess of those it would expect to pay based on taxable income. The current rules (which the Company has challenged in court) do not clearly allow the Company to obtain a refund or to offset this excess income tax against other taxes. As of February 28, 2019 and August 31, 2018, the Company had deferred tax assets of approximately \$2.2 million and \$2.1 million in this country, respectively. Also, the Company had an income tax receivable balance of \$7.0 million and \$7.1 million as of February 28, 2019 and August 31, 2018, respectively, related to excess payments from fiscal years 2015 to 2019. In the third quarter of fiscal year 2018, a revised minimum tax law was passed in this country, which beginning in fiscal 2020 will reduce the minimum tax rate. Additionally, this law clarifies rules on a going-forward basis for reimbursement of excess minimum tax paid beginning in fiscal year 2019, but does not address periods prior to fiscal year 2019. Nevertheless, the Company has not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets, because the Company believes that it is more likely than not that it will succeed in its refund request and/or court challenge on this matter.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## 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 February 28,	Open Locations(1)	
2020	\$ 13,383	
2021	12,176	
2022	11,178	
2023	11,595	
2024	11,611	
Thereafter	129,875	
Total	\$ 189,818	(2)

- (1) Operating lease obligations have been reduced by approximately \$2.8 million to reflect sub-lease income. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.
- (2) Future minimum lease payments include \$2.0 million of lease payment obligations for the prior leased Miami distribution center. For the purposes of calculating the minimum lease payments, a reduction is reflected for the actual sub-lease income the Company expects to receive during the remaining lease term. This sub-lease income was also considered, for the purposes of calculating the exit obligation, which was immaterial as of February 28, 2019 and August 31, 2018.

In January 2017, the Company purchased a distribution center in Medley, Miami-Dade County, Florida. The Company transferred its Miami dry distribution center activities that were previously in the leased facility to the new facility during the third quarter of fiscal year 2017. As of February 28, 2019, all of the vacated space has been subleased (and/or returned to the landlord). As part of the subleases the Company provided the landlord of the leased facility a letter of credit (“LOC”) for the initial amount of \$500,000 which entitled the landlord to draw on the LOC based on a decreasing scale over four years, if certain conditions occur related to nonpayment by the new tenant. The balance of this LOC decreases at an annual rate of \$125,000 starting in August 2018. As of February 28, 2019, the remaining balance of the LOC was \$375,000. Although this agreement is considered a guarantee, in measuring the fair value, the Company considers the risk and probability of default by the third party tenant as not likely nor

probable based on the Company's review of the third party tenant's financial position as well as the third party's considerable capital investment into the leased facility. Therefore, the Company has not recorded a liability for this guarantee.

The Company is also committed to non-cancelable construction services obligations for various warehouse club developments and expansions. As of February 28, 2019 and August 31, 2018, the Company had approximately \$18.8 million and \$10.6 million, respectively, in contractual obligations for construction services not yet rendered.

The Company has entered into land purchase option agreements that have not been recorded as commitments, for which the Company has recorded within restricted cash and deposits as of February 28, 2019 and August 31, 2018 approximately \$4.4 million and \$400,000, respectively. The Company's land purchase option agreements are typically subject to various conditions, including, but not limited to, the ability to obtain necessary governmental permits or approvals. A deposit under an agreement is typically returned to the Company if all permits or approvals are not obtained. Generally, the Company has the right to cancel any of our agreements to purchase land without cause by forfeiture of some or all of the deposits we have made pursuant to the agreement. The Company does not have a timetable of when or if it will exercise these land purchase options, due to the uncertainty related to the completion of the Company's due diligence reviews. The Company's due diligence reviews include evaluations of the legal status of each property, the zoning and permitting issues related to acquiring approval for the construction and operation of a warehouse club and any other issues related to the property itself that could render the property unsuitable or limit the property's economic viability as a warehouse club site. If the purchase option agreements are exercised, the cash use would be approximately \$52.1 million.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The table below summarizes the Company's interest in real estate joint ventures, commitments to additional future investments and the Company's maximum exposure to loss as a result of its involvement in these joint venture as of February 28, 2019 (in thousands):

Entity	% Ownership	Initial Investment	Additional Investments	Net (Loss)/Income Inception to Date	Company's Variable Interest in Entity	Commitment to Future Additional Investments(1)	Company's Maximum Exposure to Loss in Entity(2)
GolfPark Plaza, S.A.	50 %	\$ 4,616	\$ 2,402	\$ 201	\$ 7,219	\$ 99	\$ 7,318
Price Plaza Alajuela PPA, S.A.	50 %	2,193	1,236	66	3,495	785	4,280
Total		\$ 6,809	\$ 3,638	\$ 267	\$ 10,714	\$ 884	\$ 11,598

- (1) The parties intend to seek alternate financing for the project, which could reduce the amount of investments each party would be required to provide. The parties may mutually agree on changes to the project, which could increase or decrease the amount of contributions each party is required to provide.
- (2) The maximum exposure is determined by adding the Company's variable interest in the entity and any explicit or implicit arrangements that could require the Company to provide additional financial support.

The Company contracts for distribution center services in Mexico and for off-site data recovery services, as part of its disaster recovery plan. Future minimum service commitments related to both these contracts are not material.

## NOTE 7 – DEBT

Short-term borrowings consist of unsecured lines of credit. The following table summarizes the balances of total facilities, facilities used and facilities available (in thousands):

	Total	Facilities Used	Letters of Credit	Short-term Borrowings	Facilities Available	Weighted average interest rate	
February 28, 2019	\$ 69,000	\$ —	\$ 406	\$ 68,594	—	—	%
August 31, 2018	\$ 69,000	\$ —	\$ 632	\$ 68,368	—	—	%

As of February 28, 2019 and August 31, 2018, the Company had approximately \$40.0 million of short-term facilities in the U.S. that require compliance with certain quarterly financial covenants. As of February 28, 2019 and August 31, 2018, the Company was in compliance with respect to these covenants. Each of the facilities expires annually except for the U.S. facility, which expires bi-annually. The facilities are normally renewed.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table provides the changes in long-term debt for the six-months ended February 28, 2019:

(Amounts in thousands)	Current portion of long-term debt	Long-term debt (net of current portion)	Total
Balances as of August 31, 2018	\$ 14,855	\$ 87,720	\$ 102,575 (1)
Regularly scheduled loan payments	(1,563)	(4,782)	(6,345)
Reclassifications of long-term debt	13,138	(13,138)	—
Translation adjustments on foreign currency debt of subsidiaries whose functional currency is not the U.S. dollar (2)	(237)	(7)	(244)
Balances as of February 28, 2019	\$ 26,193	\$ 69,793	\$ 95,986 (3)

- (1) The carrying amount of non-cash assets assigned as collateral for these loans was \$125.9 million. No cash assets were assigned as collateral for these loans.
- (2) These foreign currency translation adjustments are recorded within Other comprehensive income.
- (3) The carrying amount of non-cash assets assigned as collateral for these loans was \$118.6 million. No cash assets were assigned as collateral for these loans.

As of February 28, 2019, the Company had approximately \$88.5 million of long-term loans in the U.S., Trinidad, Panama, El Salvador, Honduras, Costa Rica and Colombia that require these subsidiaries to comply with certain annual or quarterly financial covenants, which include debt service and leverage ratios. As of February 28, 2019, the Company was in compliance with all covenants or amended covenants.

As of August 31, 2018, the Company had approximately \$93.6 million of long-term loans in Trinidad, Panama, El Salvador, Honduras, Costa Rica, Barbados, and Colombia that require these subsidiaries to comply with certain annual or quarterly financial covenants.

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

Twelve Months Ended February 28,	Amount
2020	\$ 26,193
2021	7,944
2022	11,679
2023	4,839
2024	15,900
Thereafter	29,431
Total	\$ 95,986

#### NOTE 8 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

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

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



Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

## Cash Flow Hedges

As of February 28, 2019, all of the Company's interest rate swap and cross-currency interest rate swap derivative financial instruments are designated and qualify as cash flow hedges. The Company formally documents the hedging relationships for its derivative instruments that qualify for hedge accounting.

The following table summarizes agreements for which the Company has recorded cash flow hedge accounting for the six months ended February 28, 2019:

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 Settlement	Subsidiary Dates
PriceSmart, Inc	7-Nov-16	MUFG Union Bank, N.A. ("Union Bank")	Interest rate swap	\$ 35,700,000	Union Bank	Variable rate 1-month Libor plus 1.7%	3.65 %	1st day of each month beginning on April 1, 2017
Costa Rica	28-Aug-15			\$ 7,500,000			7.65 %	

Edgar Filing: PRICESMART INC - Form 10-Q

		Citibank, N.A. ("Citi")	Cross currency interest rate swap		Citibank, N.A.	Variable rate 3-month Libor plus 2.50%		28th day of August, November, February, and May beginning on November 30, 2015
Honduras	26-Feb-18	Citibank, N.A. ("Citi")	Cross currency interest rate swap	\$ 13,500,000	Citibank, N.A.	Variable rate 3-month Libor plus 3.00%	9.75 %	29th day of May, August, November and February beginning May 29, 2018
El Salvador	16-Dec-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 4,000,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.78 %	29th day of each month beginning on December 29, 2014
Colombia	10-Dec-14	Citibank, N.A. ("Citi")	Cross currency interest rate swap	\$ 15,000,000	Citibank, N.A.	Variable rate 3-month Libor plus 2.8%	8.25 %	4th day of March, June, Sept, Dec. beginning on March 4, 2015
Panama	9-Dec-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 10,000,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	5.2 %	28th day of each month beginning December 29, 2014
Panama	1-Aug-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 5,000,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.89 %	21st day of each month beginning on September 22, 2014
Panama	22-May-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 3,970,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.98 %	4th day of each month beginning on June 4, 2014
Panama	25-Jun-18	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	\$ 14,625,000	Bank of Nova Scotia	Variable rate 3-month Libor plus 3.0%	5.99 %	23rd day of each month beginning on July 23, 2018

Table of Contents

PRICESMART, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

For the three and six months ended February 28, 2019 and 2018, the Company included the gain or loss on the hedged items (that is, variable-rate borrowings) in the same line item—interest expense—as the offsetting gain or loss on the related interest rate swaps as follows (in thousands):

Income Statement Classification	Interest expense on borrowings(1)	Cost of swaps (2)	Total
Interest expense for the three months ended February 28, 2019	\$ 1,210	\$ 102	\$ 1,312
Interest expense for the three months ended February 28, 2018	\$ 873	\$ 176	\$ 1,049
Interest expense for the six months ended February 28, 2019	\$ 2,403	\$ 269	\$ 2,672
Interest expense for the six months ended February 28, 2018	\$ 1,723	\$ 497	\$ 2,220

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

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

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

Floating Rate Payer (Swap Counterparty)	Notional Amount as of	
	February 28, 2019	August 31, 2018
Union Bank	\$ 35,700	\$ 35,700
Citibank N.A.	26,025	27,825
Scotiabank	22,799	25,149
Total	\$ 84,524	\$ 88,674

Edgar Filing: PRICESMART INC - Form 10-Q

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

Derivatives designated as cash flow hedging instruments	Balance Sheet Location	February 28, 2019			August 31, 2018		
		Fair Value	Net Tax Effect	Net OCI	Fair Value	Net Tax Effect	Net OCI
Cross-currency interest rate swaps	Other non-current assets	\$ 2,344	\$ (737)	\$ 1,607	\$ 2,405	\$ (819)	\$ 1,586
Interest rate swaps	Other non-current assets	1,266	(282)	984	1,959	(434)	1,525
Interest rate swaps	Other long-term liabilities	(155)	43	(112)	(8)	2	(6)
Cross-currency interest rate swaps	Other long-term liabilities	(455)	137	(318)	(494)	148	(346)
Net fair value of derivatives designated as hedging instruments		\$ 3,000	\$ (839)	\$ 2,161	\$ 3,862	\$ (1,103)	\$ 2,759

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 9 – SEGMENTS

The Company and its subsidiaries are principally engaged in the international operation of membership shopping in 41 warehouse clubs located in 12 countries and one U.S. territory that are located in Central America, the Caribbean and Colombia. In addition, the Company operates distribution centers and corporate offices in the United States. The Company has aggregated its warehouse clubs, distribution centers and corporate offices into reportable segments. The Company's reportable segments are based on management's organization of these locations into operating segments by general geographic location, used by management and the Company's chief operating decision maker in setting up management lines of responsibility, providing support services, and making operational decisions and assessments of financial performance. Segment amounts are presented after converting to U.S. dollars and consolidating eliminations. Certain revenues, operating costs and inter-company charges included in the United States segment are not allocated to the segments within this presentation, as it is impractical to do so, and they appear as reconciling items to reflect the amount eliminated on consolidation of intersegment transactions. From time to time, the Company revises the measurement of each segment's operating income and net income, including certain corporate overhead allocations, and other measures as determined by the information regularly reviewed by the Company's chief operating decision maker. When the Company does so, the previous period amounts and balances are reclassified to conform to the current period's presentation.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

	United States Operations	Central American Operations	Caribbean Operations (1)	Colombia Operations	Reconciling Items(2)	Total
Three Months Ended February 28, 2019						
Revenue from external customers	\$ 16,821	\$ 484,994	\$ 249,360	\$ 103,250	\$ —	\$ 854,425
Intersegment revenues	289,699	3,783	1,249	397	(295,128)	—
Depreciation, Property and equipment	1,950	6,003	3,439	2,121	—	13,513
Amortization, Intangibles	593	—	—	—	—	593
Operating income (loss)	4,477	35,574	15,024	3,617	(22,156)	36,536
Net income (loss) attributable to PriceSmart, Inc. (3)	1,596	28,099	13,037	3,289	(22,211)	23,810
Capital expenditures, net	1,930	20,602	5,766	1,351	—	29,649
Six Months Ended February 28, 2019						
Revenue from external customers	\$ 34,160	\$ 924,800	\$ 474,369	\$ 200,733	\$ —	\$ 1,634,062
Intersegment revenues	640,418	4,220	2,342	675	(647,655)	—
Depreciation, Property and equipment	3,910	11,873	6,630	4,224	—	26,637
Amortization, Intangibles	1,192	—	—	—	—	1,192
Operating income	3,427	64,366	27,051	7,033	(40,671)	61,206
Net income (loss) attributable to PriceSmart, Inc. (3)	(2,229)	52,284	23,022	6,104	(40,759)	38,422
Long-lived assets (other than deferred tax assets)	89,594	331,289	151,729	114,258	—	686,870
Intangibles, net	13,788	—	—	—	—	13,788
Goodwill	11,315	24,670	10,278	—	—	46,263
Total assets	149,192	592,121	329,049	187,868	—	1,258,230
Capital expenditures, net	3,616	43,373	16,261	2,738	—	65,988
Three Months Ended February 28, 2018						
Revenue from external customers	\$ 9,138	\$ 493,905	\$ 234,169	\$ 102,351	\$ —	\$ 839,563

Edgar Filing: PRICESMART INC - Form 10-Q

Intersegment revenues	274,061	—	971	119	(275,151)	—
Depreciation and amortization	1,691	5,886	2,732	2,266	—	12,575
Operating income/(loss)	1,146	36,673	13,601	3,161	(17,317)	37,264
Net income/(loss)	(13,825)	30,124	12,456	2,710	(17,317)	14,148
Capital expenditures, net	584	11,191	9,332	1,024	—	22,131
Six Months Ended February 28, 2018						
Revenue from external customers	\$ 17,285	\$ 946,071	\$ 448,811	\$ 194,468	\$ —	\$ 1,606,635
Intersegment revenues	614,189	—	2,178	317	(616,684)	—
Depreciation and amortization	3,435	11,409	5,409	4,559	—	24,812
Operating income	4,237	69,206	25,225	5,209	(33,447)	70,430
Net income	(14,390)	57,512	22,926	4,037	(33,447)	36,638
Capital expenditures, net	1,588	22,561	19,629	1,856	—	45,634
Long-lived assets (other than deferred tax assets)	68,597	308,085	136,589	126,914	—	640,185
Goodwill	—	30,926	4,547	—	—	35,473
Total assets	129,623	552,343	320,848	188,910	—	1,191,724
As of August 31, 2018						
Long-lived assets (other than deferred tax assets)	67,650	320,612	150,516	118,284	—	657,062
Intangibles, net	14,980	—	—	—	—	14,980
Goodwill	11,230	30,646	4,453	—	—	46,329
Total assets	186,174	536,756	310,411	183,051	—	1,216,392

- (1) Management considers its club in the U.S. Virgin Islands to be part of its Caribbean operations.
- (2) The reconciling items reflect the amount eliminated on consolidation of intersegment transactions.
- (3) In March 2018, the Company acquired technology, talent and cross-border logistics infrastructure that operated a marketplace and casillero business. Investments in the technology, talent and infrastructure to expand our omni-channel capabilities, together with the operating results from the marketplace and casillero business, negatively impacted Net income attributable to PriceSmart, Inc. by \$4.2 million for the quarter and \$8.1 million for the six months ended February 28, 2019. Management considers this business to be part of its United States operations.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## NOTE 10 – ACQUISITION

On March 15, 2018, the Company acquired technology, talent and cross-border logistics infrastructure through a marketplace and casillero business operated by Aeropost, Inc. This acquisition has been accounted for in conformity with ASC Topic 805, Business Combinations. PriceSmart is actively integrating and investing in the technology, talent and infrastructure from this business to expand its omni-channel capabilities. The Company paid \$29.0 million in cash for this acquisition. Under the merger agreement, \$5.0 million of the total consideration has been placed in escrow and its release to the sellers is contingent upon certain key Aeropost, Inc. executives remaining employed with the Company for 15 months from the date of closing. The amount placed in escrow also can be used to satisfy any indemnification claims and post-closing adjustments in favor of the Company. This contingent consideration is accounted for as post-combination compensation expense, reduces the total consideration and will be recorded over this 15 month period. The post-acquisition compensation expense is recorded as prepaid expenses and other current assets on the consolidated balance sheet, and has been treated as use of cash from operating activities on the consolidated statement of cash flows.

Below is the table that summarizes the total purchase price consideration (in thousands):

Estimated consideration on the acquisition date	\$ 30,046
Estimated assumed net liabilities at acquisition date	(1,093)
Total cash consideration	28,953
Post-combination compensation expense, net of claims	(3,754)
Business acquisition, net assets acquired	\$ 25,199
Cash acquired	1,208
Business acquisition, net of cash acquired	\$ 23,991

Below summarizes the fair value of the assets acquired and liabilities assumed (in thousands):

Current assets	\$ 4,196
----------------	----------



Other non-current assets	746
Property, plant and equipment	2,059
Intangible assets	16,100
Goodwill	11,411
Deferred tax assets, long-term	4,078
Total assets acquired	\$ 38,590
Current liabilities	(5,862)
Non-current liabilities	(6,967)
Noncontrolling interest	(562)
Net assets acquired	\$ 25,199

Goodwill represents the excess of the total purchase price over the fair value of the underlying assets. The goodwill is not expected to be deductible for tax purposes. The Company recorded an immaterial adjustment to the provisional amounts of goodwill and deferred tax assets, long-term related to facts and circumstances that existed as of the acquisition date.

The following sets forth the results of the amounts preliminarily assigned to the identifiable intangible assets acquired (in thousands):

	Amortization Period	Fair value of Assets Acquired
Trade name	25 years	\$ 5,100
Developed technology	5 years	11,000
Total assets acquired		\$ 16,100

The fair value of the intangible assets is measured based on assumptions and estimations with regards to variable factors such as the amount and timing of future cash flows, appropriate risk-adjusted discount rates, nonperformance risk or other factors that market participants would consider. The trade name and developed technology were valued using the income-based approach and royalty income method, respectively. Intangible assets are amortized on a straight-line basis over the amortization periods noted above, which is included in general and administrative expenses on the accompanying consolidated statements of income.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following unaudited pro forma financial information shows the combined results of operations of the Company, including Aeropost, Inc., as if the acquisition had occurred as of the beginning of the periods presented (in thousands):

	Three Months Ended February 28, 2018	Six Months Ended February 28, 2018
Pro forma total revenues	\$ 850,629	\$ 1,627,004
Pro forma net income attributable to PriceSmart, Inc. (1)	\$ 10,900	\$ 30,018
Pro forma net income attributable to noncontrolling interest	\$ 231	\$ 292

(1) Includes the pro forma recognition of \$720,000 and \$1.5 million post-combination compensation expense, which represents three and six months of continued service amortization required to satisfy the \$3.8 million remaining purchase price contingency.

The following is summary financial information for Aeropost, Inc., including costs to expand omni-channel capabilities for fiscal year 2019 (in thousands):

	Three Months Ended February 28, 2019		Six Months Ended February 28, 2019	
	February 28, 2018	February 28, 2018	February 28, 2018	February 28, 2018
Total revenue	\$ 9,977	\$ N/A	\$ 19,127	\$ N/A
Net loss (net of tax benefits)	\$ (4,201)	\$ N/A	\$ (8,096)	\$ N/A

NOTE 11 – SUBSEQUENT EVENTS

The Company has evaluated all events subsequent to the balance sheet date of February 28, 2019 through the date of issuance of these consolidated financial statements and has determined that there are no subsequent events that require disclosure.

Table of Contents

PRICESMART, INC.

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

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

- Natural disasters that might cause damages not covered by insurance;
- Negative macroeconomic conditions;
- Volatility in foreign currency exchange rates and limitations on our ability to convert foreign currency to U.S. dollars;
- Changes in, and inconsistent enforcement of, laws and regulations in countries where we operate, including those related to tariffs and taxes;
- Compliance risks;
- Crime and security concerns, which can adversely affect the economies of the countries in which we operate and which require us to incur additional costs to provide additional security at our warehouse clubs;
- Recoverability of moneys owed to PriceSmart from governments in countries where we do business;
- The possibility of operational interruptions, including those related to union work stoppages;
- Political instability, such as recent unrest in Honduras, the ongoing anti-government protests in Nicaragua that have disrupted our operations there, and a general strike in Costa Rica led by public-sector unions that disrupted normal commerce in September 2018;
- In March 2019, the President of the United States directed the U.S. State Department to cut off \$450 million of planned aid to Guatemala, Honduras and El Salvador. Eliminating this aid could adversely impact the economies of these countries and lead to further political instability, with the resulting impact on our business;
- Changes in consumer shopping preferences;
- Significant competition, including from international online retailers or the market entrance of other club operators;
- Limitations on the availability of appropriate sites for new warehouse clubs, which could adversely affect growth;
- Failure to establish an e-commerce presence to allow our members to choose a physical or online shopping channel that is convenient for them and efficient for us may materially adversely affect our market position, net sales and financial performance, and costs associated with our increasing investments in technological resources intended to fuel sales growth and drive efficiencies may adversely affect our short-term results of operations;
- Acquisitions, such as our acquisition of Aeropost, Inc. in March 2018, may expose us to additional risks, such as retention of key personnel, previously undisclosed liabilities or compliance issues, integration challenges, impairment of goodwill or intangible assets, and diversion of management resources;
- Cost increases from product and service providers;

- Interruption of supply chains, which might adversely impact on our ability to import merchandise;
- Failure to maintain our brand's reputation;
- Exposure to product liability claims and product recalls;
- Failure to maintain our computer systems and/or disruption in those systems;
- Cybersecurity risks, such as a failure to maintain the security of the information we hold relating to our company, our members, employees and suppliers;
- Risks associated with executive leadership and organizational transition, failure to attract and/or retain other qualified employees, increases in wage and benefit costs, changes in laws and other labor issues;
- Changes in accounting standards affecting management's financial assumptions, projections, estimates and judgments; and
- A few of our stockholders own approximately 24.5% of our voting stock as of February 28, 2019, which may make it difficult to complete some corporate transactions without their support and may impede a change in control.

The risks described above as well as the other risks detailed in the Company's U.S. Securities and Exchange Commission ("SEC") reports, including the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2018 filed on October 25, 2018 (see "Part I - Item 1A - Risk Factors") could materially and adversely affect our business, financial condition and results of operations. These risks are not the only risks that the Company faces. The Company could also be affected by

Table of Contents

additional factors that apply to all companies operating globally and in the U.S., as well as other risks that are not presently known to the Company or that the Company currently considers to be immaterial.

The following discussion and analysis compares the results of operations for the three and six months ended February 28, 2019 and 2018 and should be read in conjunction with the consolidated financial statements and the accompanying notes included therein.

Our business consists primarily of operating international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. We operate in 13 countries/territories that are located in Latin America and the Caribbean. Our ownership in all operating subsidiaries as of February 28, 2019 is 100%, and they are presented on a consolidated basis. The number of warehouse clubs for each country or territory are as follows:

Country/Territory	Number of Warehouse Clubs in Operation as of February 28, 2018	Number of Warehouse Clubs in Operation as of February 28, 2019	Anticipated Additional Warehouse Club Openings In Fiscal Year 2019	Anticipated Warehouse Club Openings In Fiscal Year 2020
Colombia	7	7	—	—
Costa Rica	7	7	—	—
Panama	5	5	1	(1)
Trinidad	4	4	—	—
Dominican Republic	3	4	1	(1)
Guatemala	3	3	—	1
Honduras	3	3	—	—
El Salvador	2	2	—	—
Nicaragua	2	2	—	—
Aruba	1	1	—	—
Barbados	1	1	—	—
U.S. Virgin Islands	1	1	—	—
Jamaica	1	1	—	—
Totals	40	41	2	2

- (1) Small format warehouse club.

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

In May 2018, the Company acquired land in Panama and the Dominican Republic upon which the Company is constructing new warehouse clubs. In Panama, the site is in the city of Santiago, which is a smaller city three hours west of Panama City by car and, upon completion, will be the sixth warehouse club in Panama. In the Dominican Republic, the site is in the city of Santo Domingo, a major metropolitan area, and upon completion, will be the fifth warehouse club in the Dominican Republic. These warehouse clubs are currently expected to open in the spring and summer of 2019, respectively. Both of these warehouse clubs will be designed using our new small warehouse club format with sales floor square footage between 30,000 to 40,000 square feet, compared to 50,000 to 60,000 sales floor square footage within our most recent standard format warehouse club openings. These warehouse clubs represent our first developments of these smaller format stores intended to reach into additional geographic areas and provide more convenience for our members. In September 2018 (fiscal year 2019), we acquired land in San Cristobal, Guatemala, upon which the Company is constructing a standard format warehouse club. San Cristobal is expected to open in the fall of 2019. In November 2018 (fiscal year 2019), PriceSmart leased land within the Metropark development on the south eastern side of Panama City, Panama, upon which the Company is constructing a standard format warehouse club. The Metropark club will be the Company's seventh warehouse club in Panama and is expected to open in the fall of 2019. We continue to explore and negotiate for other potential sites for future warehouse clubs in Central America, the Caribbean and Colombia. Once these four new clubs are open, we will operate 45 warehouse clubs.

#### General Market Factors

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

Table of Contents

Currency fluctuations can be one of the largest variables affecting our overall sales and profit performance, as we have experienced in prior fiscal years, because many of our markets are susceptible to foreign currency exchange rate volatility. During the first six months of fiscal year 2019 and fiscal year 2018, approximately 78% of our net merchandise sales were in currencies other than the U.S. dollar. Of those sales, 52% were comprised of sales of products we purchased in U.S. dollars.

A devaluation of the local currency reduces the value of sales and membership income that is generated in that country when translated to U.S. dollars for our consolidated results, and we may elect to increase the local currency price of imported merchandise to maintain our target margins, which would impact demand for a significant portion of the Company's merchandise offering. Information about the effect of local currency devaluations is discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations - Net Merchandise Sales and Comparable Sales".

From time to time, one or more markets in which we operate may experience economic slowdowns, which can negatively impact our business. For example, Trinidad, which depends on oil and gas exports as a major source of income, has been experiencing overall difficult economic conditions for the past three years. These adverse economic conditions, combined with government policies intended to manage foreign currency reserves, have adversely affected consumer spending. Other countries where recent general market conditions have provided a difficult operating environment during fiscal year 2019 include Costa Rica, Panama, Dominican Republic, Guatemala, Nicaragua and Barbados. Our business in USVI, where Hurricanes Irma and Maria had a severe impact on the infrastructure of the island in September 2017 and October 2017, has rebounded due to the re-construction efforts and the difficulty other retailers are having in becoming fully operational. Significant reductions in US Financial Aid to countries where we operate may also impact our markets.

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

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



Political and other factors in each of our markets may have significant effects on our business. For example, beginning in April 2018, protests against social reforms and violent clashes with national security forces significantly impeded normal economic activity in Nicaragua, the effect of which has continued during the first six months of fiscal year 2019. Also, labor strikes in Costa Rica disrupted normal commerce in September 2018. Additionally, the need for increased tax revenue in certain countries can cause changes in tax policies affecting consumers' personal tax rates and/or added consumption taxes, such as VAT (value-added taxes), effectively raising the prices of various products.

In the past, we have experienced a lack of availability of U.S. dollars in certain markets (U.S. dollar illiquidity). This impedes our ability to convert local currencies obtained through merchandise sales into U.S. dollars to settle the U.S. dollar liabilities associated with our imported products, increasing our foreign exchange exposure to any devaluation of the local currency relative to the U.S. dollar. During fiscal year 2018 and during the first six months of fiscal year 2019, we experienced this situation in Trinidad ("TT"). We are working with our banks in Trinidad to source tradeable currencies (including Euros, British Pounds, and Canadian dollars), but until the central bank in Trinidad makes more U.S. dollars available, this illiquidity condition is likely to continue. As of February 28, 2019, our Trinidad subsidiary had a net U.S. dollar denominated asset position of approximately \$20.7 million, an increase of \$7.7 million from August 31, 2018 when our Trinidad subsidiary had net U.S. dollar denominated asset position of approximately \$13.0 million. We are carefully monitoring the situation, which may require us to limit future shipments from the U.S. to Trinidad in line with our ability to exchange Trinidad dollars for tradeable currencies to manage our exposure to any potential devaluation.

## Business Strategy

Our business strategy is to improve the quality of life for our business and family Members by making available a wide range of high quality merchandise sourced from around the world at exceptional values. The annual membership fee enables us to operate our business, as well as offer services, with lower margins than traditional retail stores. Through the use of technology and the development of an omni-channel platform, we are pursuing opportunities to respond to how our Members expect to shop, create additional efficiencies in the distribution process and increase our significance in our Members' lives. We are working to create a shopping experience that blends the attributes and appeal of our brick and mortar business with the conveniences associated with technology-supported transactions and online shopping.

Table of Contents

Growth

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

Current and Future Management Actions

Logistics and distribution efficiencies are fundamental to what allows us to deliver high quality merchandise at low prices to our members. We acquire approximately 52% of our merchandise internationally, a significant portion of which we receive at our Miami distribution centers. In January 2017, we purchased a distribution center in Medley, Miami-Dade County, Florida, into which we transferred our Miami dry distribution center activities from a leased facility during the third quarter of fiscal year 2017. This distribution facility has increased our ability to efficiently receive, handle and distribute merchandise. The efficiency with which we receive, handle and distribute merchandise to the point where our members put that merchandise into their shopping carts has a significant impact on our level of operating expenses and ultimately how low we can price our merchandise. We continue to explore ways to improve efficiency, reduce costs and ensure a good flow of merchandise to our warehouse clubs. As we continue to refine our logistics and distribution infrastructure, we are investing in regional distribution centers. This past year we entered into a long-term lease for a 165,000 square foot distribution center in Costa Rica. We began operating in this distribution center during the fall of 2018.

Purchasing land and constructing warehouse clubs is generally our largest ongoing capital investment. Securing land for warehouse club locations is challenging within our markets, especially in Colombia, because suitable sites at economically feasible prices are difficult to find. Real estate ownership provides a number of advantages as compared to leasing, including lower operating expenses, flexibility to expand or otherwise enhance our buildings, long-term control over the use of the property and the residual value that the real estate may have in future years. While our preference is to own rather than lease real estate, we have entered into real estate leases in certain cases and will likely do so in the future. Most recently we have entered into a real estate lease in Panama City, Panama, for the construction of a warehouse club.

In 2017 we began evaluating options to replace our existing Enterprise Resource Planning (ERP) system. However, due to the rapidly evolving retail and technological landscape, as well as our recent acquisition of technology and talent through Aeropost, we have delayed this project. We are currently evaluating more holistically our overall IT landscape and strategy, we will reconsider the need, timing, scope and will adjust our ERP replacement project accordingly.

We are developing an expansion of our omni-channel capability, including through our e-commerce platform, by investing in and integrating the technology, talent and cross-border logistics infrastructure obtained as part of the acquisition, in March 2018, of a company which also operates a marketplace and casillero business. We expect these investments and this integration to enhance the membership shopping experience, drive efficiencies and fuel sales growth. The first significant step in this process is the expected launch in the Dominican Republic of an e-commerce platform in conjunction with the opening of our new club there, which is expected to open in the summer of 2019.

Table of Contents

Financial highlights for the three months ended February 28, 2019 included:

- Total revenues increased 1.8% over the comparable prior year period. Revenues from our marketplace and casillero operations of \$9.9 million contributed 120 basis points (1.2%) of this increase.
- Net merchandise sales increased 0.5% over the comparable prior-year period. We ended the quarter with 41 warehouse clubs compared to 40 warehouse clubs at the end of the second quarter of fiscal year 2018.
- Comparable net merchandise sales (that is, sales in the warehouse clubs that have been open for greater than 13 ½ calendar months) for the 13 weeks ended March 3, 2019 decreased 0.9%, impacted primarily by the devaluation of the Costa Rica Colon, an increasingly competitive retail environment in Panama, and ongoing instability in Nicaragua.
- Membership income for the second quarter of fiscal year 2019 increased 1.1% to \$12.8 million over the comparable prior-year period.
- Merchandise gross profits (net merchandise sales less associated cost of goods sold) decreased 2.1% over the comparable prior year period and warehouse gross profits as a percent of net merchandise club sales were 14.0%, a decrease of 40 basis points (0.4%) from the same period last year.
- Investments in technology, talent and infrastructure to expand our omni-channel capabilities, together with the operating results from our marketplace and casillero business, negatively impacted Net income attributable to PriceSmart, Inc. by \$4.2 million.
- Operating income for the second quarter of fiscal year 2019 was \$36.5 million, compared to \$37.3 million in the second quarter of fiscal year 2018.
- We recorded a \$368,000 net currency loss from currency transactions in the current quarter compared to a \$210,000 net gain in the same period last year.
- The tax provision of \$11.7 million resulted in an effective tax rate for the second quarter of fiscal year 2019 of 32.9%. The effective tax rate for the second quarter of fiscal year 2018 was 61.6%. In the second quarter of fiscal year 2018, we recorded a one-time transitional repatriation tax on unremitted foreign earnings totaling \$13.4 million as part of the U.S. Tax Cuts and Jobs Act of 2017 (“U.S. Tax Reform”).
- Net income attributable to PriceSmart, Inc. for the second quarter of fiscal year 2019 was \$23.8 million, or \$0.79 per diluted share, compared to \$14.1 million, or \$0.47 per diluted share, in the comparable prior-year period.

Financial highlights for the six months ended February 28, 2019 included:

- Total revenues increased 1.7% over the comparable prior year period. Revenues from our marketplace and casillero operations of \$19.0 million contributed 120 basis points (1.2%) of this increase.
- Net merchandise sales increased 0.4% over the comparable prior-year period. We ended the quarter with 41 warehouse clubs compared to 40 warehouse clubs at the end of the second quarter of fiscal year 2018.
- Comparable net merchandise sales (that is, sales in the warehouse clubs that have been open for greater than 13 ½ calendar months) for the 26 weeks ended March 3, 2019 decreased 1.4%, impacted primarily by the Costa Rica Colon devaluation, an increasingly competitive retail environment in Panama, and ongoing instability in Nicaragua.
- Membership income for the first six months of fiscal year 2019 increased 2.0% to \$25.6 million over the comparable prior-year period.
- Merchandise gross profits (net merchandise sales less associated cost of goods sold) decreased 1.9% over the comparable prior year period and warehouse gross profits as a percent of net merchandise club sales were 14.1%, a

- decrease of 30 basis points (0.3%) from the same period last year.
- Investments in technology, talent and infrastructure to expand our omni-channel capabilities, together with the operating results from our marketplace and casillero business, negatively impacted Net income attributable to PriceSmart, Inc. by \$8.1 million.
  - Operating income for the first six months of fiscal year 2019 was \$61.2 million, compared to \$70.4 million in the first six months of fiscal year 2018.
  - We recorded a \$2.1 million net currency loss from currency transactions in the current six-month period compared to a \$488,000 net gain in the same period last year.
  - The effective tax rate for the first six months of fiscal year 2019 was 33.3%, as compared to the effective tax rate for the first six months of fiscal year 2018 of 47.3%, primarily related to a one-time transitional repatriation tax on unremitted foreign earnings totaling \$13.4 million recorded in the prior year period as part of U.S. Tax Reform.
  - Net income attributable to PriceSmart, Inc. for the first six months of fiscal year 2019 was \$38.4 million, or \$1.27 per diluted share, compared to \$36.6 million, or \$1.21 per diluted share, in the comparable prior-year period.

Table of Contents

## COMPARISON OF THE THREE AND SIX MONTHS ENDED FEBRUARY 28, 2019 AND 2018

The following discussion and analysis compares the results of operations for the three-month and six-month periods ended on February 28, 2019 with the three-month and six-month periods ended on February 28, 2018 and should be read in conjunction with the consolidated financial statements and the accompanying notes included elsewhere in this report. Unless otherwise noted, all tables on the following pages present U.S. dollar amounts in thousands. Certain percentages presented are calculated using actual results prior to rounding.

## Net Merchandise Sales

The following tables indicate the net merchandise club sales in the segments in which we operate and the percentage growth in net merchandise sales by segment during the three and six-months ended February 28, 2019 and 2018.

	Three Months Ended February 28, 2019			February 28, 2018		
	Amount	% of net sales	Increase/ (decrease) from prior year	Change	Amount	% of net sales
Central America	\$ 473,161	57.7 %	\$ (12,118)	(2.5) %	\$ 485,279	59.4 %
Caribbean	245,728	30.0 %	14,897	6.5 %	230,831	28.3 %
Colombia	101,401	12.3 %	938	0.9 %	100,463	12.3 %
Net merchandise sales	\$ 820,290	100.0 %	\$ 3,717	0.5 %	\$ 816,573	100.0 %

	Six Months Ended February 28, 2019			February 28, 2018		
	Amount	% of net sales	Increase/ (decrease) from prior year	Change	Amount	% of net sales

Edgar Filing: PRICESMART INC - Form 10-Q

Central America	\$ 903,545	57.6 %	\$ (25,401)	(2.7) %	\$ 928,946	59.5 %
Caribbean	467,223	29.8 %	24,953	5.6 %	442,270	28.3 %
Colombia	196,965	12.6 %	6,207	3.3 %	190,758	12.2 %
Net merchandise sales	\$ 1,567,733	100.0 %	\$ 5,759	0.4 %	\$ 1,561,974	100.0 %

Comparison of Three and Six Months Ended February 28, 2019 and 2018

Overall, total net merchandise sales grew 0.5% for the second quarter and 0.4% for the six-month period ended February 28, 2019. The second quarter increase resulted from a 3.4% increase in transactions and a 2.8% decrease in average ticket. For the six-month period, the increase resulted from a 3.0% increase in transactions and a 2.6% decrease in average ticket.

Net merchandise sales in our Central America segment decreased 2.5% and 2.7% for the second quarter and the six-months ended February 28, 2019, respectively, when compared to the same period last year. These declines had a 150 basis point (1.5%) and 170 basis point (1.7%) negative impact on total net merchandise sales growth, respectively. Economic weakness, currency devaluation, and political instability led to decreased sales within our Panama, Guatemala, Costa Rica, Dominican Republic, and Nicaragua markets, offset by year-on-year increased merchandise sales within our Honduras and El Salvador markets.

Net merchandise sales in our Caribbean segment grew 6.5% and 5.6% for the second quarter and the six-months ended February 28, 2019, when compared to the same period last year. These increases had a 190 basis point (1.9%) and 160 basis point (1.6%) positive impact on total net merchandise sales growth, respectively. With the exception of our Barbados market, all markets within this segment showed increased net merchandise sales year-on-year.

Net merchandise sales in our Colombia segment grew 0.9% and 3.3% for the second quarter and the six-months ended February 28, 2019, when compared to the same period last year. These increases had a 10 basis point (0.1%) and 40 basis point (0.4%) positive impact on total net merchandise sales growth, respectively. The growth is primarily due to an improving economy and the continued growth in the market's acceptance of the warehouse club concept.

Table of Contents

In discussing our operating results, the term “currency exchange rates” refers to the currency exchange rates we use to convert the operating results for all countries where the functional currency is not the U.S. dollar into U.S. dollars. We calculate the effect of changes in currency exchange rates as the difference between current period activities translated using the current period's currency exchange rates, and the comparable prior year period's currency exchange rates. The disclosure of constant currency amounts or results permits investors to better understand our underlying performance without the effects of currency exchange rate fluctuations. The following table indicates the impact that currency exchange rates had on our net merchandise sales in dollars and the percentage change from the three and six month periods ended February 28, 2019.

	Currency exchange rate fluctuations for the Three Months Ended February 28, 2019		
	Amount	% change	
Central America	\$ (17,144)	(3.6)	%
Caribbean	(3,682)	(1.5)	%
Colombia	(9,058)	(8.9)	%
Net merchandise sales	\$ (29,884)	(3.6)	%

  

	Currency exchange rate fluctuations for the Six Months Ended February 28, 2019		
	Amount	% change to prior year	
Central America	\$ (28,950)	(3.2)	%
Caribbean	(6,696)	(1.4)	%
Colombia	(13,529)	(6.9)	%
Net merchandise sales	\$ (49,175)	(3.1)	%

Overall, the effects of currency devaluations within our markets had an approximately \$29.9 million and \$49.2 million, or 360 basis point (3.6%) and 310 basis points (3.1%), negative constant currency impact on net merchandise sales for the quarter and six-months ended February 28, 2019.



Currency devaluations had a \$17.1 million and \$29.0 million, or 360 basis point (3.6%) and 320 basis point (3.2%), negative constant currency impact on net merchandise sales in our Central America segment for the quarter and six months ended February 28, 2019. The currency devaluations contributed approximately 210 basis points (2.1%) and 180 basis points (1.8%) of the total negative impact on total net merchandise sales, respectively. Costa Rica, Guatemala, Honduras and our Nicaragua markets all experienced currency devaluation when compared to the same period last year.

Currency devaluations had a \$3.7 million and \$6.7 million, or 150 basis point (1.5%) and 140 basis point (1.4%), negative constant currency impact on reported net merchandise sales in our Caribbean segment for the quarter and the six months ended February 28, 2019. The currency devaluations contributed approximately 40 basis points (0.4%) of the total negative impact on total net merchandise sales for both the quarter and the six months period, respectively. This is reflective of the offsetting devaluation and appreciation of the mix of currencies within the markets in this segment when compared to the same period a year ago.

Currency devaluations had a \$9.1 million and \$13.5 million, or 890 basis point (8.9%) and 690 basis points (6.9%), negative constant currency impact on net merchandise sales in our Colombia segment for the quarter and six-months ended February 28, 2019. The currency devaluations contributed approximately 110 basis points (1.1%) and 90 basis points (0.9%) of the total negative impact on total net merchandise sales, respectively.

Table of Contents

## Comparable Merchandise Sales

We report comparable merchandise club sales on a “same week” basis with 13 weeks in each quarter beginning on a Monday and ending on a Sunday. The periods are established at the beginning of the fiscal year to provide as close a match as possible to the calendar month and quarter that is used for financial reporting purposes. This approach equalizes the number of weekend days and weekdays in each period for improved sales comparison, as we experience higher merchandise club sales on the weekends. Each of the warehouse clubs used in the calculations was open for at least 13 ½ calendar months before its results for the current period were compared with its results for the prior period. For example, sales related to the warehouse club opened in Costa Rica on October 5, 2017 were not used in the calculation of comparable sales until December 2018 and the sales related to our warehouse club in the Dominican Republic opened on May 3, 2018 will not be used in the calculation of comparable sales until July 2019.

The following table indicates comparable net merchandise sales in the reportable segments in which we operate, and the percentage growth in net merchandise sales by segment during fiscal years 2019 and 2018.

	Thirteen Weeks Ended			
	March 3, 2019		March 4, 2018	
	% Increase/(decrease)			
	in comparable			
	net		in comparable	
	warehouse		net warehouse	
	sales		sales	
Central America	(2.5)	%	1.1	%
Caribbean	1.7	%	7.2	%
Colombia	1.1	%	12.0	%
Consolidated segments	(0.9)	%	4.1	%

Twenty-Six Weeks Ended  
 March 3,  
 2019            March 4, 2018

% Increase/(decrease)

in comparable % Increase/(decrease)

	net warehouse sales	%	in comparable net warehouse sales	%
Central America	(3.5)	%	0.6	%
Caribbean	0.8	%	5.4	%
Colombia	3.1	%	11.7	%
Consolidated segments	(1.4)	%	3.2	%

#### Comparison of Three and Six Months Ended February 28, 2019 and 2018

Comparable merchandise club sales for those warehouse clubs that were open for at least 13 ½ months for some or all of the 13-week period ended March 3, 2019 decreased 0.9% when compared to the prior year. Comparable merchandise club sales that were open for at least 13 ½ months for some or all of the 26-week period ended on March 3, 2019 decreased 1.4%.

Comparable merchandise sales in our Central America segment decreased 2.5% and 3.5% for the second quarter and the six-months ended February 28, 2019. These decreases contributed approximately 150 basis points (1.5%) and 200 basis points (2.0%) of the decrease in total comparable merchandise sales, respectively.

For the quarter, the negative economic conditions, foreign currency devaluation, and socio-political conditions within our Costa Rica, Panama, Guatemala, and Nicaragua markets contributed approximately 170 basis points (1.7%) of the decrease, which was offset by a 20 basis point (0.2%) increase in Honduras and El Salvador. For the six-month period, this segment's comparable merchandise sales were impacted by the opening of our seventh warehouse club in Costa Rica in an area called Santa Ana. Often times, new warehouse clubs that we open are not far from existing warehouse clubs that are included in the calculation for comparable warehouse club sales resulting in a transfer of some sales from an existing club (in this case Escazu) to the new club. This transfer of sales from existing warehouse clubs that are included in the calculation of comparable merchandise sales to new warehouse clubs that are not included in the calculation can have an adverse impact on reported comparable warehouse club sales. New warehouse clubs attract new members from areas not previously served by us and also create the opportunity for some existing members, particularly those who now find the new clubs closer to their homes, to shop more frequently. We estimate that the transfer of sales associated with the Santa Ana opening negatively impacted the total comparable merchandise sales by 50 basis points (0.5%) for the six-month period ending February 28, 2019. The balance of the decline in comparable merchandise sales for the Central America segment in the six-month period is attributable to negative economic conditions, foreign currency devaluation, and socio-political conditions in the same markets that impacted sales for the quarter. These

Table of Contents

conditions contributed approximately 180 basis points (1.8%) of the decrease, which was offset by a 30 basis point (0.3%) increase in Honduras and El Salvador.

Comparable merchandise sales in our Caribbean segment increased 1.7% and 0.8% for the second quarter and six-month period ended February 28, 2019. These increases contributed approximately 50 basis points (0.5%) and 20 basis points (0.2%) of the positive impact in total comparable merchandise sales, respectively.

The opening of our fourth warehouse club in the Dominican Republic in May 2018 impacted this segment's comparable merchandise sales. We estimate that the transfer of sales associated with this warehouse club opening negatively impacted total comparable merchandise sales by 70 basis points (0.7%) and 90 basis points (0.9%) for the respective periods.

Comparable merchandise sales in our Colombia segment increased 1.1% and 3.1% for the second quarter and six-month period ended February 28, 2019. These increases contributed approximately 10 basis points (0.1%) and 40 basis points (0.4%) of the positive impact in total comparable merchandise sales for the respective period.

The following table illustrates the impact that changes in foreign currency exchange rates had on our comparable merchandise sales in dollars and the percentage change from the three and six-month periods ended February 28, 2019.

	Currency Exchange Rate Fluctuations for the Thirteen Weeks Ended March 3, 2019		
	Amount	% change	
Central America	\$ (17,407)	(3.6)	%
Caribbean	(3,323)	(1.4)	%
Colombia	(9,180)	(9.0)	%
Comparable merchandise sales	\$ (29,910)	(3.7)	%

Currency Exchange Rate  
Fluctuations for the  
Twenty-Six Weeks Ended  
March 3, 2019

	Amount	% change	
Central America	\$ (29,028)	(3.2)	%
Caribbean	(5,845)	(1.3)	%
Colombia	(13,763)	(7.0)	%
Comparable merchandise sales	\$ (48,636)	(3.2)	%

Overall, the effects of currency devaluations within our markets had an approximately \$29.9 million and \$48.6 million, or 370 basis point (3.7%) and 320 basis points (3.2%), negative constant currency impact on comparable net merchandise sales for the quarter and six-months ended February 28, 2019, respectively.

Currency devaluations within our Central America segment accounted for approximately 220 basis points (2.2%) and 190 basis points (1.9%) of the impact of currency devaluations on total comparable merchandise sales for the quarter and six-month period, respectively. Our Costa Rica, Guatemala, Honduras and Nicaragua markets all experienced currency devaluation when compared to the same period last year.

Currency devaluations within our Caribbean segment accounted for approximately 40 basis points (0.4%) of the impact of currency devaluations on total comparable merchandise sales for the quarter and six-month period, respectively. This is reflective of the offsetting devaluation and appreciation of the mix of currencies within the markets in this segment when compared to the same period a year ago.

Currency devaluations within our Colombia segment accounted for approximately 110 basis points (1.1%) and 90 basis points (0.9%) of the impact of currency devaluations on total comparable merchandise sales for the quarter and six-month period, respectively. This reflects the devaluation of Colombia peso when compared to the same period a year ago.

Table of Contents

## Membership Income

Membership income is recognized ratably over the one-year life of the membership. The increase in membership income primarily reflects a growth in membership accounts. The table below represents the change in membership income by segment and as a percentage of net merchandise club sales of each segment:

	Three Months Ended					February 28,	
	February 28, 2019	Increase/ (decrease) from prior year	% Change	Membership income % to net merchandise club sales		February 28, 2018	Amount
Membership income - Central America	\$ 7,704	\$ (96)	(1.2) %	1.6	%	\$ 7,800	
Membership income - Caribbean	3,427	281	8.9	1.4		3,146	
Membership income - Colombia	1,714	(43)	(2.5)	1.7		1,757	
Membership income - Total	\$ 12,845	\$ 142	1.1 %	1.6	%	\$ 12,703	

  

	Six Months Ended					February 28,	
	February 28, 2019	Increase (decrease) from prior year	% Change	Membership income % to net warehouse club sales		February 28, 2018	Amount
Membership income - Central America	\$ 15,373	\$ (121)	(0.8) %	1.7	%	\$ 15,494	
Membership income - Caribbean	6,759	595	9.7	1.4		6,164	
Membership income - Colombia	3,453	33	1.0	1.8		3,420	

Edgar Filing: PRICESMART INC - Form 10-Q

Membership income - Total	\$ 25,585	\$ 507	2.0 %	1.6 %	\$ 25,078
Number of accounts - Central America	843,113	4,734	0.6 %		838,379
Number of accounts - Caribbean	425,002	26,302	6.6		398,700
Number of accounts - Colombia	340,048	18,708	5.8		321,340
Number of accounts - Total	1,608,163	49,744	3.2 %		1,558,419

Comparison of Three and Six Months Ended February 28, 2019 and 2018

The number of member accounts during the first six months of fiscal year 2019 was 3.2% higher than the year before. Membership income increased 2.0% over the same period.

The growth in membership accounts during fiscal year 2019 in our Caribbean market was primarily attributable to the opening of the new San Isidro warehouse club in the Dominican Republic in May 2018. Membership accounts in Colombia increased primarily due to an improving economy and the continued growth in the market's acceptance of the warehouse club concept. Membership accounts in Central America remained stable at 0.6% growth. The Company's twelve-month renewal rate was 85% for the periods ended February 28, 2019 and February 28, 2018.

Additionally, we continued expanding our platinum membership program. We began offering platinum memberships in the United States Virgin Islands and Honduras in October 2018 (fiscal year 2019) and March 2019, respectively. We expect to expand our platinum membership program to additional markets this year.

Table of Contents

## Other Revenue

Other revenue primarily consists of non-merchandise revenue from freight and handling fees generated from our marketplace and casillero operations, interest generating portfolio from our co-branded credit cards, and rental income from operating leases where the Company is the lessor.

	Three Months Ended			February 28,
	February 28, 2019	Increase from		2018
	Amount	prior year	% Change	Amount
Non-merchandise revenue	\$ 9,900	\$ 9,900	100.0 %	\$ —
Miscellaneous income	3,700	3,303	832.0	397
Rental income	846	94	12.5	752
Other revenue	\$ 14,446	\$ 13,297	1,157.3 %	\$ 1,149

	Six Months Ended			February 28,
	February 28, 2019	Increase from		2018
	Amount	prior year	% Change	Amount
Non-merchandise revenue	\$ 19,019	\$ 19,019	100.0 %	\$ —
Miscellaneous income	5,064	4,266	534.6	798
Rental income	1,628	128	8.5	1,500
Other revenue	\$ 25,711	\$ 23,413	1,018.8 %	\$ 2,298

## Comparison of Three and Six Months Ended February 28, 2019 and 2018

Other revenue for the quarter and six-months ended February 28, 2019 includes non-merchandise revenue generated by our marketplace and casillero operations primarily from freight and handlings charges for on-line orders placed from customers in Latin America to retailers in the United States and delivered to locations throughout Latin America



from a business we acquired in March 2018. For the quarter, the net increase of \$3.3 million in Miscellaneous income was primarily due to a \$2.2 million payment we received as a result of the underpayment to us of income earned on our co-branded credit card interest generating portfolios (“IGP”) balance over the past five years. The remaining \$1.1 million increase is mainly the result of the adoption of the new revenue standard ASC 606 in the first quarter of fiscal year 2019, which results in IGP income being included in Miscellaneous income. In prior periods, including the second quarter of fiscal 2018, IGP was recorded as a reduction of general and administrative costs in accordance with the previous revenue guidance in effect at that time.

For the six months, ended February 28, 2019, Miscellaneous income increased \$4.3 million, of which \$2.1 million is the result of the inclusion of IGP in Miscellaneous income. The remaining \$2.2 million is the reimbursement described above.

Table of Contents

## Results of Operations

Results of Operations Consolidated (Amounts in thousands, except percentages and	Three Months Ended		February 28, 2018	Increase/(Decrease)	
	February 28, 2019				
number of warehouse clubs)					
Net merchandise sales					
Net merchandise sales	\$ 820,290		\$ 816,573	\$ 3,717	
Merchandise sales gross margin	\$ 114,744		\$ 117,218	\$ (2,474)	
Merchandise sales gross margin percentage	14.0	%	14.4	% (0.4)	%
Revenues					
Total revenues	\$ 854,425		\$ 839,563	\$ 14,862	
Percentage change from prior period				1.8	%
Comparable merchandise sales					
Total comparable merchandise sales increase (decrease)	(0.9)	%	4.1	% (5.0)	%
Gross margin					
Total gross margin	\$ 137,567		\$ 131,523	\$ 6,044	
Gross margin percentage to total revenues	16.1	%	15.7	% 0.4	%
Selling, general and administrative					
Selling, general and administrative	\$ 101,031		\$ 94,259	\$ 6,772	
Selling, general and administrative percentage of total revenues	11.8	%	11.2	% 0.6	%

Results of Operations Consolidated Operating income- by segment Central America	Three Months Ended		February 28, 2018	% of Total Revenue
	February 28, 2019	% of Total Revenue		
	\$ 35,574	4.2	\$ 36,673	4.4

Edgar Filing: PRICESMART INC - Form 10-Q

Caribbean	\$ 15,024	1.8	%	\$ 13,601	1.6	%
Colombia	\$ 3,617	0.4	%	\$ 3,161	0.4	%
United States	\$ 4,477	0.5	%	\$ 1,146	0.1	%
Reconciling Items (1)	\$ (22,156)	(2.6)	%	\$ (17,317)	(2.1)	%
Operating income - Total	\$ 36,536	4.3	%	\$ 37,264	4.4	%

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

Table of Contents

Results of Operations Consolidated (Amounts in thousands, except percentages and	Six Months Ended		February 28, 2018	Increase/(Decrease)	
	February 28, 2019				
number of warehouse clubs)					
Net merchandise sales					
Net warehouse club sales	\$ 1,567,733		\$ 1,561,974	\$ 5,759	
Warehouse club sales gross margin	\$ 221,032		\$ 225,383	\$ (4,351)	
Warehouse club gross margin percentage	14.1	%	14.4	% (0.3)	%
Revenues					
Total revenues	\$ 1,634,062		\$ 1,606,635	\$ 27,427	
Percentage change from comparable period				1.7	%
Comparable merchandise sales					
Total calendar comparable warehouse club sales increase (decrease)	(1.4)	%	3.2	% (4.6)	%
Gross margin					
Total gross margin	\$ 264,024		\$ 253,610	\$ 10,414	
Gross Margin percentage to total revenues	16.2	%	15.8	% 0.4	%
Selling, general and administrative					
Selling, general and administrative	\$ 202,818		\$ 183,180	\$ 19,638	
Selling, general and administrative percentage of total revenues	12.4	%	11.4	% 1.0	%

Results of Operations Consolidated	Six Months Ended		February 28, 2018	% of Total Revenue
	February 28, 2019	% of Total Revenue		

Edgar Filing: PRICESMART INC - Form 10-Q

Operating income- by segment							
Central America	\$ 64,366	3.9	%	\$ 69,206	4.3	%	
Caribbean	\$ 27,051	1.7	%	\$ 25,225	1.6	%	
Colombia	\$ 7,033	0.4	%	\$ 5,209	0.3	%	
United States	\$ 3,427	0.2	%	\$ 4,237	0.3	%	
Reconciling Items (1)	\$ (40,671)	(2.5)	%	\$ (33,447)	(2.1)	%	
Operating income - Total	\$ 61,206	3.7	%	\$ 70,430	4.4	%	

Warehouse clubs

Warehouse clubs at period end	41	40	1
Warehouse club square feet at period end	2,085	2,020	65

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

Table of Contents

The following table summarizes the selling, general and administrative expense for the periods disclosed.

	Three Months Ended					
	February 28, 2019	% of Total Revenue		February 28, 2018	% of Total Revenue	
Warehouse club and other operations	\$ 75,708	8.9	%	\$ 71,951	8.6	%
General and administrative	24,968	2.9	%	20,258	2.4	%
Pre-opening expenses	97	—	%	81	—	%
Asset impairment	—	—	%	1,929	0.2	%
Loss/(gain) on disposal of assets	258	—	%	40	—	%
Total Selling, General and Administrative	\$ 101,031	11.8	%	\$ 94,259	11.2	%

	Six Months Ended					
	February 28, 2019	% of Total Revenue		February 28, 2018	% of Total Revenue	
Warehouse club and other operations	\$ 149,930	9.2	%	\$ 141,453	8.8	%
General and administrative	52,303	3.2	%	39,088	2.4	%
Pre-opening expenses	112	—	%	511	—	%
Asset impairment	—	—	%	1,929	0.1	%
Loss/(gain) on disposal of assets	473	—	%	199	—	%
Total Selling, General and Administrative	\$ 202,818	12.4	%	\$ 183,180	11.4	%

The following table summarizes the costs recorded as part of our consolidation of Aeropost-related activities (net of tax benefit), including costs to expand our omni-channel capabilities, the net operating results of our marketplace and casillero business and ongoing costs we recorded as part of our post-acquisition purchase accounting.

Three	Six
Months	Months
Ended	Ended
February	February
28, 2019	28, 2019
\$ 3,017	\$ 5,695

Edgar Filing: PRICESMART INC - Form 10-Q

Negative impact of Aeropost-related activities (net of tax benefit) on Net income attributable to PriceSmart, Inc., before amortization		
Amortization of intangibles (net of tax benefit)	461	927
Amortization of compensation expense	723	1,474
Negative impact of Aeropost-related activities (net of tax benefit) on Net income attributable to PriceSmart, Inc.	\$ 4,201	\$ 8,096
Impact of Aeropost-related activities (net of tax benefit) on earnings per share	\$ (0.14)	\$ (0.27)

Comparison of Three and Six Months Ended February 28, 2019 and 2018

On a consolidated basis, net merchandise sales gross margin for the quarter as a percentage of total net merchandise sales were 14.0%, 40 basis points (0.4%) lower than the second quarter of fiscal year 2018. Net merchandise margins decreased across all segments with the Central America segment contributing 20 basis points (0.2%), and the Caribbean and Colombia segments each contributing 10 basis point (0.1%) to the overall decline. The decline was driven largely from pricing actions to drive sales.

For the six-month period, consolidated net merchandise sales gross margin as a percentage of total net merchandise sales were 14.1%, which is 30 basis points (0.3%) lower than the same period of fiscal year 2018. Net merchandise margins decreased across all segments, with the Central America segment contributing 20 basis points (0.2%) and the Caribbean 10 basis points (0.1%) to the overall decline. The decline was driven largely from pricing actions to drive sales.

Total gross margin to total revenues increased 40 basis points (0.4%) in both periods presented, mainly due to higher margins on non-merchandise revenues of our marketplace and casillero business, which increased the gross margin to total revenues ratio by approximately 60 basis points (0.6%) for the quarter and six months ended fiscal year 2019. Membership income, rental income and miscellaneous income gross margin percentage remained unchanged. The reclassification of income generated from the IGP as a result of the implementation of new revenue recognition standards increased total gross margins by approximately 40 basis points (0.4%) for the quarter and 30 basis points (0.3%) for the six months ended fiscal year 2019. Additionally, in the second quarter we were reimbursed \$2.2 million resulting from the underpayment of income earned on our co-branded credit card IGP balance over the past five years. This resulted in a \$1.6 million benefit net of tax or \$0.05 per share on our results of operations for the three and six-month period ended February 28, 2019.

Table of Contents

Selling, general, and administrative expenses consist of warehouse club and other operations, general and administrative expenses, pre-opening expenses, and loss/(gain) on disposal of assets. In total, selling, general and administrative expenses increased \$6.8 million to 11.8% of total revenues compared to 11.2% of total revenues in the second quarter of fiscal year 2018.

Warehouse club and other operations expense increased to 8.9% of total revenues compared to 8.6% for the second quarter of fiscal year 2018. Our marketplace and casillero business added approximately \$4.0 million, or 50 basis points (0.5%) in costs to this line item for the three month period. This increase was offset by 20 basis points (0.2%) due to foreign currency devaluation and increased leveraging of warehouse expenses.

General and administrative expenses increased to 2.9% of total revenues compared to 2.4% for the second quarter of fiscal year 2018. Aeropost, including costs associated with further investments that will expand our omni-channel capabilities added approximately \$5.4 million, or 60 basis points (0.6%), in costs to this line item for the three-month period.

Selling, general, and administrative expenses increased \$19.6 million to 12.4% of total revenues for the six-month period ended February 28, 2019 compared to 11.4% for the same period during fiscal year 2018.

Warehouse club and other operations expense increased to 9.2% of total revenues compared to 8.8% for the six-month period ended of fiscal year 2018. Our marketplace and casillero business added approximately \$8.1 million or 50 basis points (0.5%) for the six-month period. This increase was offset by 20 basis points (0.2%) due to foreign currency devaluation and increased leveraging of warehouse expenses.

General and administrative expenses increased to 3.2% of total revenues compared to 2.4% for the six-month period ended fiscal year 2018. Our investments to expand our omni-channel capabilities, together with our marketplace and casillero business added approximately \$10.7 million, or 70 basis points (0.7%), in costs to this line item for the six-month period. Another driver for this increase was approximately \$3.8 million or 20 basis points (0.2%) recorded in the first quarter of fiscal year 2019 for separation and other related termination benefits for our former Chief Executive Officer and President who resigned in October 2018 by mutual agreement with the Board of Directors. We do not expect any significant additional charges relating to this resignation in future periods. These costs, net of tax, negatively impacted earnings per share for the six-month period ended February 28, 2019, by \$0.13 per share.



Operating income in the second quarter of fiscal year 2019 decreased to \$36.5 million (4.3% of total revenue) compared to \$37.3 million (4.4% of total revenue) for the same period last year, which reflects the decrease in gross margins on net merchandise sales and higher expenses year-on-year related to investments to expand our omni-channel capabilities, together with net operating results from our marketplace and casillero business.

Operating income for the six-months ended February 28, 2019, decreased to \$61.2 million (3.7% of total revenue) compared to \$70.4 million (4.4% of total revenue) for the same period last year. As described above, lower merchandise margins as a percent of sales, higher expenses year-on-year related to investments to expand our omni-channel capabilities, together with net operating results from our marketplace and casillero business were the primary factors for the decrease in operating income.

### Interest Expense

	Three Months Ended		
	February 28, 2019	Increase/ (decrease) from prior year	February 28, 2018
	Amount		Amount
Interest expense on loans	\$ 1,399	\$ 253	\$ 1,146
Interest expense related to hedging activity	102	(73)	175
Capitalized interest	(500)	(171)	(329)
Net interest expense	\$ 1,001	\$ 9	\$ 992

Table of Contents

	Six Months Ended		February 28, 2018
	February 28, 2019	Increase/ (decrease) from prior year	
	Amount		Amount
Interest expense on loans	\$ 2,802	\$ 465	\$ 2,337
Interest expense related to hedging activity	270	(227)	497
Less: Capitalized interest	(1,038)	(451)	(587)
Net interest expense	\$ 2,034	\$ (213)	\$ 2,247

## Comparison of Three and Six Months Ended February 28, 2019 and 2018

Net interest expense reflects borrowings by PriceSmart, Inc. and our wholly owned foreign subsidiaries to finance new land acquisition and construction for new warehouse clubs, warehouse club expansions and distribution centers, the capital requirements of warehouse club and other operations and ongoing working capital requirements.

Net interest expense increased for the three and six month periods ended February 28, 2019. The increase for both periods is primarily due to higher variable interest rates. Interest expense related to hedging activity decreased during the three and six month periods due to the pay-off of the various loans held by our subsidiaries that were hedged and the remaining hedged loans having positive, or “in the money,” positions. Additional capitalized interest for the three and six month periods of fiscal year 2019 compared to fiscal year 2018 resulted from higher levels of construction activities.

## Other Income (Expense), net

Other income consists of currency gain or loss, as well as net benefit costs related to our defined benefit plans.

	Three Months Ended			February
	February 28,			28,
	2019			2018
	(Decrease)			
	from			
	Amount	prior year	%Change	Amount
Other income (expense), net	\$ (372)	\$ (582)	(277.1)%	\$ 210

	Six Months Ended			February
	February 28,			28,
	2019			2018
	(Decrease)			
	from			
	Amount	prior year	%Change	Amount
Other income (expense), net	\$ (2,191)	\$ (2,679)	(549.0)%	\$ 488

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), are recorded as currency gains or losses. Additionally, gains or losses from transactions denominated in currencies other than the functional currency of the respective entity also generate currency gains or losses.

Table of Contents

## Comparison of Three and Six Months Ended February 28, 2019 and 2018

For the three and six month periods ended February 28, 2019, we had a net expense associated with foreign currency transactions of approximately \$368,000 for the quarter and \$2.1 million for the first six-months ended fiscal 2019. These losses resulted from the revaluation of net U.S. dollar assets and liabilities in markets where the local functional currency revalued or devalued against the U.S. dollar, and from exchange transactions, net of any exchange reserve movements. In particular, in Jamaica, we incurred a \$125,000 and \$1.6 million loss for the three and six-month periods ended February 28, 2019. The loss resulted from a 6.0% appreciation of the Jamaican dollar during the six-month period, adversely affecting the value in Jamaica of having an average U.S. dollar net asset position of \$19.1 million during fiscal 2019. The Jamaican dollar (JMD) strengthening is primarily due to the Jamaican Central Bank's intervention as part of its efforts to manage inflation this fiscal year.

## Provision for Income Taxes

U.S. Tax Reform in December 2017 lowered the federal corporate tax rate from 35% to 21% and made numerous other law changes. The table below summarizes the effect that U.S. Tax Reform had on net income and earnings per share attributable to PriceSmart available for distribution:

(In thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	February 28, 2019	February 28, 2018	February 28, 2019	February 28, 2018
Income before provision for income taxes and income (loss) of unconsolidated affiliates	\$ 35,586	\$ 36,850	\$ 57,795	\$ 69,439
Provision for income taxes calculated prior to U.S. tax law change	(11,677)	(9,912)	(19,986)	(20,027)
U.S. Tax Reform: Current tax rate reduction	782	1,427	1,110	1,427
U.S. Tax Reform: Re-measurement of net deferred tax assets/liabilities	—	(822)	—	(822)
U.S. Tax Reform: Other tax incentives	193	—	634	—
Incidental to U.S. Tax Reform: Valuation Allowances on Deferred Tax Assets	(1,001)	—	(1,001)	—
U.S. Tax Reform: Transition Tax	—	(13,400)	—	(13,400)
Subtotal of U.S. Tax Reform Effects	(26)	(12,795)	743	(12,795)
Total provision for income taxes	\$ (11,703)	\$ (22,707)	\$ (19,243)	\$ (32,822)
Income (loss) of unconsolidated affiliates	(20)	5	(44)	21

Edgar Filing: PRICESMART INC - Form 10-Q

Net income	\$ 23,863	\$ 14,148	\$ 38,508	\$ 36,638
Less: net income (loss) attributable to noncontrolling interest	(53)	—	(86)	—
Net income attributable to PriceSmart, Inc.	\$ 23,810	\$ 14,148	\$ 38,422	\$ 36,638
Net income attributable to PriceSmart, Inc. per share available for distribution:				
Basic net income per share	\$ 0.79	\$ 0.47	\$ 1.27	\$ 1.21
Diluted net income per share	\$ 0.79	\$ 0.47	\$ 1.27	\$ 1.21
Subtotal of U.S. Tax Reform Effects	\$ (26)	\$ (12,795)	\$ 743	\$ (12,795)
Impact of U.S Tax Reform on basic and diluted net income per share	\$ —	\$ (0.42)	\$ 0.02	\$ (0.42)

	Three Months Ended		
	February 28,		February 28,
	2019	Increase/ (decrease) from	2018
	Amount	prior year	Amount
Current tax expense	\$ 12,234	\$ (3,455)	\$ 15,689
Net deferred tax provision (benefit)	(531)	(7,549)	7,018
Provision for income taxes	\$ 11,703	\$ (11,004)	\$ 22,707
Effective tax rate	32.9 %		61.6 %

Table of Contents

	Six Months Ended		February 28, 2018
	February 28, 2019	Increase/ (decrease) from prior year	
	Amount		Amount
Current tax expense	\$ 20,159	\$ (5,994)	\$ 26,153
Net deferred tax provision (benefit)	(916)	(7,585)	6,669
Provision for income taxes	\$ 19,243	\$ (13,579)	\$ 32,822
Effective tax rate	33.3 %		47.3 %

## Comparison of Three and Six Months Ended February 28, 2019 and 2018

For the three months ended February 28, 2019, the effective tax rate was 32.9%. The decrease in the effective tax rate versus the prior year was primarily attributable to the following factors:

- The favorable impact of 36.4% resulting from nonrecurrence of the U.S. Tax Reform Transition Tax and favorable impact of 2.3% from nonrecurrence of the re-measurement of net deferred tax assets/liabilities in the second quarter of fiscal 2018.
- A comparably unfavorable net impact of 3.5%, resulting from the combination of: the U.S. Tax Reform rate reduction, which less favorably impacted our effective tax rate than previously, resulting in a 1.2% unfavorable impact, the favorable impact of 0.5% resulting from new export-related sales and service tax incentives, and the unfavorable impact of 2.8% from valuation allowances on deferred tax assets from foreign tax credits that, incidental to U.S. Tax Reform are no longer deemed recoverable.
- The comparably unfavorable impact of 3.2% resulting from the effective tax rate impact of costs incurred to expand our omni-channel capabilities and the net operating results of our marketplace and casillero business.
- The comparably unfavorable impact on the effective tax rate of 1.3% resulting from a decrease in the magnitude of an intercompany transaction between PriceSmart, Inc. and our Colombian subsidiary in support of PriceSmart's

ongoing market development and growth in Colombia compared to prior year. The intercompany transaction reduces taxable income in the U.S. and increases taxable income in our Colombia subsidiary where the additional taxable income is fully offset by the reversal of valuation allowances on accumulated net losses in that subsidiary. We expect the decrease of this favorable impact to the consolidated Company's effective tax rate to continue through the remainder of fiscal year 2019.

- The comparably favorable impact of 0.4% resulting from improved financial results in our Colombia subsidiary for which no tax attribute was recognized, net of adjustment to valuation allowance;

Table of Contents

For the six months ended February 28, 2019, the effective tax rate was 33.3%. The decrease in the effective tax rate versus the prior year was primarily attributable to the following factors:

- The favorable impact of 19.3% resulting from nonrecurrence of the U.S. Tax Reform Transition Tax and favorable impact of 1.2% from nonrecurrence of the re-measurement of net deferred tax assets/liabilities in the second quarter of fiscal 2018.
- A comparably unfavorable net impact of 0.8%, resulting from the combination of: the U.S. Tax Reform rate reduction, which less favorably impacted our effective tax rate than previously, resulting in a 0.2%, unfavorable impact, the favorable impact of 1.1% resulting from new export-related sales and service tax incentives, and the unfavorable impact of 1.7% from allowances on deferred tax assets from foreign tax credits that, incidental to U.S. Tax Reform, are no longer deemed recoverable.
- The comparably unfavorable impact of 3.4% resulting from the effective tax rate impact of costs incurred to expand our omni-channel capabilities and the net operating results of our marketplace and casillero business.
- The comparatively unfavorable impact on the effective tax rate of 1.1% resulting from a decrease in the magnitude of an intercompany transaction between PriceSmart, Inc. and our Colombian subsidiary in support of PriceSmart's ongoing market development and growth in Colombia compared to prior year. The intercompany transaction reduces taxable income in the U.S. and increases taxable income in our Colombia subsidiary where the additional taxable income is fully offset by the reversal of valuation allowances on accumulated net losses in that subsidiary. We expect the decrease of the favorable impact to the consolidated Company's effective tax rate to continue through the remainder of fiscal year 2019.
- The comparably favorable impact of 1.0% resulting from improved financial results in our Colombia subsidiary for which no tax attribute was recognized, net of adjustment to valuation allowance;
- The comparably unfavorable impact of 1.4% resulting from separation costs associated with the departure of our former C.E.O.

Other Comprehensive Income (Loss)



Edgar Filing: PRICESMART INC - Form 10-Q

	Three Months Ended			February
	February 28,			28,
	2019			2018
		(Decrease)		
	from			
	Amount	prior year	% Change	Amount
Other comprehensive income (loss)	\$ 4,352	\$ (866)	(16.6) %	\$ 5,218

	Six Months Ended			February
	February 28,			28,
	2019			2018
		(Decrease)		
	from			
	Amount	prior year	% Change	Amount
Other comprehensive income (loss)	\$ (8,894)	\$ (12,703)	(333.5) %	\$ 3,809

Comparison of Three and Six Months Ended February 28, 2019 and 2018

Our other comprehensive income of approximately \$4.4 million for the second quarter of fiscal year 2019 resulted primarily from comprehensive income of approximately \$5.1 million from foreign currency translation adjustments related to assets and liabilities and the translation of revenue, costs and expenses on the statements of income of our subsidiaries whose functional currency is not the U.S. dollar offset by comprehensive loss of approximately \$791,000 related to unrealized gains on changes in derivative obligations. When the functional currency in our international subsidiaries is the local currency and not U.S. dollars, the assets and liabilities of such subsidiaries are translated to U.S. dollars at the exchange rate on the balance sheet date, and revenue, costs and expenses are translated at average rates of exchange in effect during the period. The corresponding translation differences are recorded as a component of accumulated other comprehensive income or loss. These adjustments would not affect net income unless the underlying investment in our local subsidiaries were liquidated. The reported other

Table of Contents

comprehensive income or loss reflects the unrealized increase or decrease in the value in U.S. dollars of the net assets of the subsidiaries as of the date of the balance sheet, which will vary from period to period as exchange rates fluctuate. For the six-months ended February 28, 2019, other comprehensive loss of approximately \$8.9 million resulted primarily from a comprehensive loss of approximately \$8.3 million from foreign currency translation adjustments related to assets and liabilities and the translation of revenue, costs and expenses on the statements of income of our subsidiaries whose functional currency is not the U.S. dollar. Additionally, there was a comprehensive loss of approximately \$668,000 related to unrealized gains on changes in derivative obligations.

LIQUIDITY AND CAPITAL RESOURCES

Financial Position and Cash Flow

Our operations have historically supplied us with a significant source of liquidity. Our cash flows provided by operating activities, supplemented with our long-term debt and short-term borrowings, have generally been sufficient to fund our operations while allowing us to invest in activities that support the long-term growth of our operations and to pay dividends on our common stock. We evaluate our funding requirements on a regular basis to cover any shortfall in our ability to generate sufficient cash from operations to meet our capital requirements. We may consider funding alternatives to provide additional liquidity when necessary.

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

The following table summarizes the cash and cash equivalents, including restricted cash, held by our foreign subsidiaries and domestically (in thousands).

February	August
28,	31,

Edgar Filing: PRICESMART INC - Form 10-Q

	2019	2018
Amounts held by foreign subsidiaries	\$ 85,971	\$ 79,454
Amounts held domestically	12,106	17,460
Total cash and cash equivalents, including restricted cash	\$ 98,077	\$ 96,914

The following table summarizes the short-term investments held by our foreign subsidiaries and domestically (in thousands).

	February 28, 2019	August 31, 2018
Amounts held by foreign subsidiaries	\$ 23,501	\$ 32,304
Amounts held domestically	—	—
Total short-term investments	\$ 23,501	\$ 32,304

From time to time, we have experienced a lack of availability of U.S. dollars in certain markets (U.S. dollar illiquidity). This impedes our ability to convert local currencies obtained through merchandise sales into U.S. dollars to settle the U.S. dollar liabilities associated with our imported products. Since fiscal year 2017, we have experienced this situation in Trinidad and have been unable to source a sufficient level of tradeable currencies in Trinidad. We are working with our banks in Trinidad to source tradeable currencies. We expect the illiquid market conditions in Trinidad to continue.

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

	Six Months Ended		
	February 28, 2019	February 28, 2018	Increase/ (Decrease)
Net cash provided by (used in) operating activities	\$ 76,300	\$ 59,079	\$ 17,221
Net cash provided by (used in) investing activities	(53,817)	(104,924)	51,107
Net cash provided by (used in) financing activities	(19,833)	(21,859)	2,026
Effect of exchange rates	(1,487)	(1,142)	(345)
Net increase (decrease) in cash and cash equivalents	\$ 1,163	\$ (68,846)	\$ 70,009



Table of Contents

We reported a year-on-year increase in the cash equivalents used of approximately \$70.0 million. The primary factors in the year-on-year improvement in the use of cash were changes in cash provided by operating activities and cash used in investing activities. The increase in cash provided from operating activities was approximately \$17.2 million when compared to the same period a year ago. This was primarily due to the year-on-year increase in accounts payable of approximately \$33.3 million offset by an increase in inventory of \$10.0 million and higher receivables of \$6.3 million. The increase in inventory is due to having more clubs and the increased receivables is attributable to our acquisition of Aeropost. Net cash used in investing activities decreased approximately \$51.1 million year-on-year. This was primarily due to the year-on-year net decrease in cash used for short-term investments of approximately \$67.5 million, as we decreased the portion of cash, cash equivalents and short-term investments held as short-term investments. This was offset by year-on-year increases in additions to property and equipment of approximately \$16.4 million as we increased, year-on-year, investments in new warehouse clubs as construction of four new warehouse clubs is underway in Panama, the Dominican Republic and Guatemala.

The following table summarizes the dividends declared and paid during fiscal year 2019 and 2018.

Declared	Amount	First Payment			Amount	Second Payment			Amount
		Record Date	Date Paid	Date Payable		Record Date	Date Paid	Date Payable	
1/30/2019	\$ 0.70	2/15/2019	2/28/2019	N/A	\$ 0.35	8/15/2019	N/A	8/30/2019	\$ 0.35
1/24/2018	\$ 0.70	2/14/2018	2/28/2018	N/A	\$ 0.35	8/15/2018	8/31/2018	N/A	\$ 0.35

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

#### Short-Term Borrowings and Long-Term Debt

Short-term borrowings consist of unsecured lines of credit. The following table summarizes the balances of total facilities, facilities used and facilities available (in thousands):

	Total Amount of Facilities	Facilities Used		Facilities Available	Weighted average interest rate
		Short-term Borrowings	Letters Credit		
February 28, 2019	\$ 69,000	\$ —	\$ 406	\$ 68,594	— %
August 31, 2018	\$ 69,000	\$ —	\$ 632	\$ 68,368	— %

As of February 28, 2019 and August 31, 2018, the Company had approximately \$40.0 million of short-term facilities in the U.S. that require compliance with certain quarterly financial covenants. As of February 28, 2019 and August 31, 2018, the Company was in compliance with respect to these covenants. Each of the facilities expires annually except for the U.S. facility, which expires bi-annually. The facilities are normally renewed.

The following table provides the changes in our long-term debt for the six months ended February 28, 2019:

(Amounts in thousands)	Current portion of long-term debt	Long-term debt (net of current portion)	Total
Balances as of August 31, 2018	\$ 14,855	\$ 87,720	\$ 102,575 (1)
Regularly scheduled loan payments	(1,563)	(4,782)	(6,345)
Reclassifications of long-term debt	13,138	(13,138)	—
Translation adjustments on foreign currency debt of subsidiaries whose functional currency is not the U.S. dollar (2)	(237)	(7)	(244)
Balances as of February 28, 2019	\$ 26,193	\$ 69,793	\$ 95,986 (3)

- (1) The carrying amount of non-cash assets assigned as collateral for these loans was \$125.9 million. No cash assets were assigned as collateral for these loans.
- (2) These foreign currency translation adjustments are recorded within Other comprehensive income.
- (3) The carrying amount of non-cash assets assigned as collateral for these loans was \$118.6 million. No cash assets were assigned as collateral for these loans.

Table of Contents

As of February 28, 2019, the Company had approximately \$88.5 million of long-term loans in the U.S., Trinidad, Panama, El Salvador, Honduras, Costa Rica, Barbados and Colombia that require compliance with certain annual or quarterly financial covenants, which include debt service and leverage ratios. As of February 28, 2019, the Company was in compliance with all covenants or amended covenants.

As of August 31, 2018, the Company had approximately \$93.6 million of long-term loans in Trinidad, Panama, El Salvador, Honduras, Costa Rica, Barbados and Colombia that require these subsidiaries to comply with certain annual or quarterly financial covenants. As of August 31, 2018, the Company was in compliance with all covenants or amended covenants.

## Derivatives

We are exposed to certain risks relating to our ongoing business operations. We manage the exposure associated with interest rate and foreign currency exchange rate risks by using derivative financial instruments. The objective of entering into derivatives is to eliminate the variability of cash flows resulting from changes in interest rates and foreign currency exchange rates associated with servicing our debt and our subsidiaries' merchandise-related foreign currency commitments. We measure the fair value for all financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis during the reporting period.

The following table summarizes the effect of the fair value of interest rate swap and cross-currency interest rate swap derivative instruments that we have designated and qualify for derivative hedge accounting and its associated tax effect on accumulated other comprehensive (income) / loss (in thousands):

Derivatives designated as cash flow hedging instruments	Balance Sheet Location	February 28, 2019			August 31, 2018		
		Fair Value	Net Tax Effect	Net OCI	Fair Value	Net Tax Effect	Net OCI
Cross-currency interest rate swaps	Other non-current assets	\$ 2,344	\$ (737)	\$ 1,607	\$ 2,405	\$ (819)	\$ 1,586
Interest rate swaps	Other non-current assets	1,266	(282)	984	1,959	(434)	1,525
Interest rate swaps	Other long-term liabilities	(155)	43	(112)	(8)	2	(6)
Cross-currency interest rate swaps	Other long-term liabilities	(455)	137	(318)	(494)	148	(346)

Net fair value of derivatives  
designated as hedging  
instruments

\$ 3,000 \$ (839) \$ 2,161 \$ 3,862 \$ (1,103) \$ 2,759

From time to time, we enter into non-deliverable forward exchange contracts. These contracts are treated for accounting purposes as fair value contracts and do not qualify for derivative hedge accounting. As of February 28, 2019 and August 31, 2018, the Company did not have any open non-deliverable forward foreign-exchange contracts.

#### Off-Balance Sheet Arrangements

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

#### Repurchase of Equity Securities and Reissuance of Treasury Shares

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

Shares of common stock repurchased by us are recorded at cost as treasury stock and result in the reduction of stockholders' equity in our consolidated balance sheets. We may reissue these treasury shares.



Table of Contents

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.

	Six Months Ended	
	February 28,	February 28,
	2019	2018
Shares repurchased	38,944	21,513
Cost of repurchase of shares (in thousands)	\$ 2,417	\$ 1,833

We have reissued treasury shares as part of our stock-based compensation programs. However, we did not reissue any treasury shares during the first six months of fiscal years 2019 and 2018.

## Critical Accounting Estimates

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

**Income Taxes:** We account for income taxes using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and carry-forwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established when necessary to reduce deferred tax assets to amounts expected to be realized. As of February 28, 2019, we evaluated our deferred tax assets and liabilities and determined that a valuation allowance was necessary for certain deferred tax asset balances, primarily because of the existence of

significant negative objective evidence, such as the fact that certain subsidiaries are in a cumulative loss position for the past three years, indicating that certain net operating loss carry-forward periods are not sufficient to realize the related deferred tax assets. We also specifically considered whether foreign tax credit balances could be utilized in the foreseeable future in light of current and future U.S. tax liabilities. We have historically applied foreign tax credits, generated from taxes withheld on certain payments PriceSmart receives from its foreign subsidiaries, to reduce U.S. income tax liabilities. However, as an incidental result of U.S. tax reform, following the reduction of the U.S. corporate income tax rate from 35% to 21%, we expect foreign tax credits generated to exceed U.S. income tax liability for the foreseeable future. Therefore, as of February 28, 2019, we have recorded valuation allowance of \$1.0 million against our foreign tax credits.

We are required to file federal and state income tax returns in the United States and various other tax returns in foreign jurisdictions. The preparation of these tax returns requires us to interpret the applicable tax laws and regulations in effect in such jurisdictions, which could affect the amount of tax we pay. We, in consultation with our tax advisors, base our tax returns on interpretations that we believe 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 we file our tax returns. As part of these reviews, a taxing authority may disagree with respect to the interpretations we used to calculate our tax liability and, therefore, require us to pay additional taxes.

We accrue an amount for our estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained. This requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. When facts and circumstances change, we reassess these probabilities and record any changes in the consolidated financial statements as appropriate. There were no material changes in our uncertain income tax positions as of February 28, 2019 and August 31, 2018.

**Tax Receivables:** We pay a Value Added Tax (“VAT”) or similar taxes (“input VAT”), income taxes, and other taxes within the normal course of our business in most of the countries in which we operate related to the procurement of merchandise and/or services we acquires and/or on sales and taxable income. We also collect VAT or similar taxes on behalf of the government (“output VAT”) for merchandise and/or services we sell. If the output VAT exceeds the input VAT, then the difference is remitted

Table of Contents

to the government, usually on a monthly basis. If the input VAT exceeds the output VAT, this creates a VAT receivable. In most countries where we operate, the governments have implemented additional collection procedures, such as requiring credit card processors to remit a portion of sales processed via credit card directly to the government as advance payments of VAT and/or income tax. In the case of VAT, these procedures alter the natural offset of input and output VAT and generally leave us with a net VAT receivable, forcing us to process significant refund claims on a recurring basis. With respect to income taxes paid, if the estimated income taxes paid or withheld exceed the actual income tax due this creates an income tax receivable. We either request a refund of these tax receivables or apply the balance to expected future tax payments. These refund or offset processes can take anywhere from several months to several years to complete.

In most countries where we operate, the VAT refund process is defined and structured with regular refunds or offsets. However, we, together with our tax and legal advisers, is currently seeking clarification in court in one country without a clearly defined process but where we expect to prevail. The balance of the VAT receivable in the country with undefined refund mechanisms was approximately \$3.8 million and \$3.1 million as of February 28, 2019 and August 31, 2018, respectively. In another country in which we have warehouse clubs, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires us to pay taxes based on a percentage of sales rather than income. As a result, we are making income tax payments substantially in excess of those we would expect to pay based on taxable income. The rules (which we have challenged in court) effective for fiscal years 2015 to 2018 do not clearly allow us to obtain a refund or offset this excess income tax against other taxes. As of February 28, 2019, we had deferred tax assets of approximately \$2.2 million in this country. Also, we had an income tax receivable balance of \$7.0 million as of February 28, 2019 related to excess payments from fiscal year 2015 to 2019. In the third quarter of fiscal year 2018, a revised minimum tax law was passed in this country, which beginning in fiscal year 2020 will reduce the minimum tax rate. Additionally, this law clarifies rules on a go-forward basis for reimbursement of excess minimum tax paid beginning in fiscal year 2019, but not for prior years. Nevertheless, we have not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets because we believe that it is more likely than not that we will ultimately succeed in these refund requests, related appeals and/or court challenge on these matters.

Our policy for classification and presentation of VAT receivables, income tax receivables and other tax receivables is as follows:

- Short-term VAT and Income tax receivables, recorded as Other current assets: This classification is used for any countries where our subsidiary has generally demonstrated the ability to recover the VAT or income tax receivable within one year. We also classify as short-term any approved refunds or credit notes to the extent that we expect to receive the refund or use the credit notes within one year.
- Long-term VAT and Income tax receivables, recorded as Other non-current assets: This classification is used for amounts not approved for refund or credit in countries where our subsidiary has not demonstrated the ability to obtain refunds within one year and/or for amounts which are subject to outstanding disputes. An allowance is provided against VAT and income tax receivable balances in dispute when we do not expect to eventually prevail in

its recovery of such balances. We do not currently have any allowances provided against VAT and income tax receivables.

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

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

Management's judgments are based on market and operational conditions at the time of the evaluation and can include management's best estimate of future business activity, which in turn drives estimates of future cash flows from these assets. These periodic evaluations could cause management to conclude that impairment factors exist, requiring an adjustment of these assets to their then-current fair market value. Loss/(gain) on disposal of assets recorded during the years reported resulted from improvements to operations and normal preventive maintenance.

Table of Contents

Business Combinations: We applied the provisions of ASC 805, Business Combinations, in accounting for the acquisition of Aeropost. It required us to recognize separately from goodwill the assets acquired and the liabilities assumed at the acquisition date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the assets acquired and the liabilities assumed. While we used our best estimates and assumptions to accurately value assets acquired and liabilities assumed at the acquisition date as well as any contingent consideration, where applicable, our estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the assets acquired and liabilities assumed with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments will be recorded to our consolidated statements of operations.

Accounting for a business combination required our management to make significant estimates and assumptions, especially at the acquisition date, including our estimates of the value of intangible assets, contractual obligations assumed, pre-acquisition contingencies and any contingent consideration, where applicable. Although we believe that the assumptions and estimates we have made for the acquisition of Aeropost are reasonable and appropriate, they are based in part on historical experience and information obtained from the management of the acquired company and are inherently uncertain.

Examples of critical estimates in valuing certain of the intangible assets we have acquired include but are not limited to:

- future expected cash flows from the existing revenue streams of Aeropost, including the related estimates of amounts and timing and estimated costs to sell, market, deliver and support such revenues, among other estimates;
- future expected cash flows from acquired developed technology including estimated amounts to be received for such developed technology and the time period over which such cash flows are expected to be received, among other estimates; and
- discount rates.

Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates or actual results.

We may identify certain pre-acquisition contingencies as of the acquisition date and may extend our review and evaluation of these pre-acquisition contingencies throughout the measurement period in order to obtain sufficient

information to assess whether we should include these contingencies as a part of the fair value estimates of assets acquired and liabilities assumed and, if so, determine their estimated amounts.

If we cannot reasonably determine the fair value of a pre-acquisition contingency (non-income tax related) by the end of the measurement period, which is generally the case given the nature of such matters, we will recognize an asset or a liability for such pre-acquisition contingency if: (1) it is probable that an asset existed or a liability had been incurred at the acquisition date and (2) the amount of the asset or liability can be reasonably estimated.

Subsequent to the measurement period, changes in our estimates of such contingencies will affect earnings and could have a material effect on our results of operations and financial position.

In addition, uncertain tax positions and tax-related valuation allowances assumed in connection with a business combination are initially estimated as of the acquisition date. We reevaluate these items quarterly, with any adjustments to our preliminary estimates being recorded to goodwill if identified within the measurement period. Subsequent to the measurement period or our final determination of the tax allowance's or contingency's estimated value, whichever comes first, changes to these uncertain tax positions and tax-related valuation allowances will affect our provision for income taxes in our consolidated statement of operations and could have a material impact on our results of operations and financial position. For the period ended February 28, 2019, there were no significant changes in the estimates of these positions or valuation allowances.

### Seasonality

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

Table of Contents

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risks relating to our operations result primarily from changes in interest rates and changes in currency exchange rates. There have been no material changes in our market risk factors at February 28, 2019 compared to those disclosed in our Annual Report on Form 10-K for the fiscal year ended August 31, 2018. The gross fair value of our derivative financial instruments designated as cash flow hedges has decreased by \$860,000 since August 31, 2018, primarily due to the fluctuations in interest rates, fluctuations in exchange rates for the currencies that are being hedged, and changes in the scheduled maturities of the underlying instruments during the six months ended February 28, 2019. Movements in currency exchange rates and the related impact on the translation of the balance sheets of our subsidiaries whose functional currency is not the U.S. dollar were the cause of the \$8.3 million loss in the foreign currency translation adjustments category of accumulated other comprehensive income (loss) for the six months ended February 28, 2019.

In addition, the monetary assets and liabilities of our subsidiaries whose functional currency is not the U.S. dollar that are denominated in currencies other than the functional currency of the respective entity (primarily U.S. dollars) are revalued to the functional currency using the exchange rate on the balance sheet date. These foreign exchange transaction gains (losses), including transactions recorded involving these monetary assets and liabilities, are recorded as currency gain (loss) within Other income (expense) in the consolidated statements of income.

The following table summarizes the amounts recorded for the three and six months ending February 28, 2019 and 2018 (in thousands):

	Three Months Ended		Six Months Ended	
	February 28, 2019	February 28, 2018	February 28, 2019	February 28, 2018
Currency gain (loss)	\$ (368)	\$ 210	\$ (2,123)	\$ 488

From time to time, we have experienced a lack of availability of U.S. dollars in certain markets (U.S. dollar illiquidity). This impedes our ability to convert local currencies obtained through merchandise sales into U.S. dollars to settle the U.S. dollar liabilities associated with our imported products. Since fiscal year 2017, we have experienced this situation in Trinidad and have been unable to source a sufficient level of tradeable currencies in Trinidad. We are working with our banks in Trinidad to source tradeable currencies. We expect the illiquid market conditions in Trinidad to continue.

As of February 28, 2019, our Trinidad subsidiary had net U.S. dollar denominated asset of approximately \$20.7 million, an increase of \$7.7 million from August 31, 2018 when our Trinidad subsidiary had a net U.S. dollar denominated asset of approximately \$13.0 million. We are carefully monitoring the situation, which may require us to limit future shipments from the U.S. to Trinidad in line with our ability to exchange Trinidad dollars for tradeable currencies to manage our exposure to any potential devaluation.



Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

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

Management has excluded from its assessment the internal control over financial reporting for the Aeropost business acquired on March 15, 2018. The Aeropost business constitutes 1% of total assets as of February 28, 2019 and 1% of total revenues for the six-months then ended. The losses from Aeropost that are subject to this exclusion represent 13% of total net income attributable to PriceSmart for the six-month period ended February 28, 2019. For the purposes of quantifying the significance of the acquired business subject to this control exclusion, management has not excluded amounts covered by the Company's internal control over financial reporting. For example, certain compensation expenses, professional fees and intangible amortization associated with Aeropost are accounted for by PriceSmart directly and subject to PriceSmart's control structure. The Aeropost business will be in scope for management's assessment as of August 31, 2019.

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

Changes in Internal Control over Financial Reporting

We disclosed in our Annual Report on Form 10-K for the year ended August 31, 2018, the conclusion of the Principal Executive Officer and Principal Financial Officer that the Company's disclosure controls and procedures were not effective at the reasonable assurance level as of the end of fiscal year 2018, as a result of a material weakness relating to the classification of certain financial instruments as cash equivalents or short-term investments.

During fiscal year 2019, management has evaluated the design and operating effectiveness of internal controls related to the classification of certain financial instruments as cash equivalents or short-term investments and has taken the following steps to remediate the identified material weakness:

- Revised the design of existing controls and implemented additional compensating controls and procedures to ensure the proper classification of financial instruments as cash equivalents, short-term, or long-term investments.
- Implemented process improvements to enhance management oversight of the review of the activity of the financial instruments to ensure that these revised controls and additional compensating controls are operating effectively.

During fiscal 2019, management tested the remedial controls related to the material weakness described above for a sufficient period of time, and management has concluded, through testing, that by the end of the second quarter of fiscal 2019, these controls were operating effectively. Therefore, we have concluded that the material weakness previously identified in the Company's internal control over financial reporting has been remediated at February 28, 2019.

Despite the previously identified and now remediated material weakness, the Company believes that the consolidated financial statements included in the first quarter fiscal year 2019 Quarterly Report on Form 10-Q and the consolidated financial statements included in fiscal year 2018 Form 10-K fairly present, in all material respects, the Company's financial condition, results of operations and cash flows for the periods presented in conformity with U.S. generally accepted accounting principles.

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

Table of Contents

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

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are often involved in claims arising in the ordinary course of business seeking monetary damages and other relief. Based upon information currently available to us, none of these claims is expected to have a material adverse effect on our business, financial condition or results of operations.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this Quarterly Report on Form 10-Q, the reader should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended August 31, 2018. There have been no material changes in the Company's risk factors from those disclosed in Part I, Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2018.

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

(a) None.

(b) None.

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

Edgar Filing: PRICESMART INC - Form 10-Q

Upon vesting of restricted stock awarded by the Company to employees, the Company repurchases shares and withholds the amount of the repurchase payment to cover employees' tax withholding obligations. As set forth in the table below, during the quarter ended February 28, 2019, the Company repurchased 38,944 shares in the indicated months. These were the only repurchases of equity securities made by the Company during the second quarter of fiscal year 2019. The Company does not have a stock repurchase program.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
December 1, 2018 - December 31, 2018	—	\$ —	—	N/A
January 1, 2019 - January 31 2019	38,270	\$ 62.09	—	N/A
February 1, 2019 - February 28, 2019	674	\$ 60.33	—	N/A
Total	38,944	\$ 62.05	—	—

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.



Table of Contents

ITEM 6. EXHIBITS

(a) Exhibits:

- 3.1(1) Amended and Restated Certificate of Incorporation of the Company.
- 3.2(2) Certificate of Amendment of Amended and Restated Certificate of Incorporation of the Company.
- 3.3(3) Certificate of Amendment of Amended and Restated Certificate of Incorporation of the Company.
- 3.4(4) Amended and Restated Bylaws of the Company.
- 31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1\*\* Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2\*\* Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Identifies management contract or compensatory plan or arrangement.

\*\* These certifications are being furnished solely to accompany this Report pursuant to 18 U.S.C. 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and are not to be

Edgar Filing: PRICESMART INC - Form 10-Q

incorporated by reference into any filing of PriceSmart, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.

- (1) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended August 31, 1997 filed with the Commission on November 26, 1997.
- (2) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended February 29, 2004 filed with the Commission on April 14, 2004.
- (3) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended August 31, 2004 filed with the Commission on November 24, 2004.
- (4) Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on July 17, 2015.

Table of Contents

SIGNATURES

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

PRICESMART, INC.

Date: April 9, 2019 By: /s/ SHERRY S. BAHRAMBEGUI  
Sherry S. Bahrambeygui  
Chief Executive Officer  
(Principal Executive Officer)

Date: April 9, 2019 By: /s/ MAARTEN O. JAGER  
Maarten O. Jager  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer and  
Principal Accounting Officer)