PRICESMART INC
Form 10-Q
January 05, 2017

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 November 30, 2016

OR

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

For the transition period from to

COMMISSION FILE NUMBER 0-22793

PriceSmart, Inc.

(Exact name of registrant as specified in its charter)

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

9740 Scranton Road, San Diego, CA 92121

(Address of principal executive offices)

(858) 404-8800

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

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

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

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

Yes No

The registrant had 30,406,399 shares of its common stock, par value $0.0001 per share, outstanding at December 31, 2016.

PRICESMART, INC.

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PriceSmart, Inc.'s ("PriceSmart," "we" or the "Company") unaudited consolidated balance sheet as of November 30, 2016 and the consolidated balance sheet as of August 31, 2016, the unaudited consolidated statements of income for the three months ended November 30, 2016 and 2015, the unaudited consolidated statements of comprehensive income for the three months ended November 30, 2016 and 2015, the unaudited consolidated statements of equity for the three months ended November 30, 2016 and 2015, and the unaudited consolidated statements of cash flows for the three months ended November 30, 2016 and 2015, are included herein. Also included herein are the notes to the unaudited consolidated financial statements.

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PRICESMART, INC.

CONSOLIDATED BALANCE SHEETS

(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

	November 30, 2016 (Unaudited)	August 31, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 175,402	$ 199,522
Short-term restricted cash	517	518
Receivables, net of allowance for doubtful accounts of $7 as of November 30, 2016 and August 31, 2016, respectively	7,761	7,464
Merchandise inventories	326,989	282,907
Prepaid expenses and other current assets	24,194	22,143
Total current assets	534,863	512,554
Long-term restricted cash	2,735	2,676
Property and equipment, net	469,423	473,045
Goodwill	35,603	35,637
Deferred tax assets	11,783	12,258
Other non-current assets (includes $4,163 and $3,224 as of November 30, 2016 and August 31, 2016, respectively, for the fair value of derivative instruments)	52,690	49,798
Investment in unconsolidated affiliates	10,773	10,767
Total Assets	$ 1,117,870	$ 1,096,735
LIABILITIES AND EQUITY		
Current Liabilities:		
Short-term borrowings	$ 12,211	$ 16,534
Accounts payable	280,601	267,173
Accrued salaries and benefits	17,645	19,606
Deferred membership income	20,905	20,920
Income taxes payable	4,892	4,226
Other accrued expenses (includes $153 and $110 as of November 30, 2016 and August 31, 2016, respectively, for the fair value of foreign currency forward contracts)	25,450	24,880
Long-term debt, current portion	14,664	14,565
Total current liabilities	376,368	367,904
Deferred tax liability	1,647	1,760
Long-term portion of deferred rent	8,759	8,961
Long-term income taxes payable, net of current portion	883	970
Long-term debt, net of current portion	69,788	73,542
Other long-term liabilities (includes $1,030 and $1,514 for the fair value of derivative instruments and $4,394 and $4,013 for post employment plans as of November 30,	5,424	5,527

2016 and August 31, 2016, respectively)		
Total Liabilities	462,869	458,664

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Equity:				
Common stock $0.0001 par value, 45,000,000 shares authorized; 31,242,784 and 31,237,658 shares issued and 30,406,433 and 30,401,307 shares outstanding (net of treasury shares) as of November 30, 2016 and August 31, 2016, respectively		3		3
Additional paid-in capital		414,811		412,369
Tax benefit from stock-based compensation		11,321		11,321
Accumulated other comprehensive loss		(114,332)		(103,951)
Retained earnings		375,929		351,060
Less: treasury stock at cost, 836,351 shares as of November 30, 2016 and August 31, 2016, respectively		(32,731)		(32,731)
Total Equity		655,001		638,071
Total Liabilities and Equity	$	1,117,870	$	1,096,735

See accompanying notes.

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PRICESMART, INC.

CONSOLIDATED STATEMENTS OF INCOME

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

	Three Months Ended	
	November 30, 2016	November 30, 2015
Revenues:		
Net warehouse club sales	$ 716,079	$ 690,831
Export sales	10,734	8,232
Membership income	11,710	11,466
Other income	1,049	1,402
Total revenues	739,572	711,931
Operating expenses:		
Cost of goods sold:		
Net warehouse club	608,490	590,183
Export	10,181	7,832
Selling, general and administrative:		
Warehouse club operations	65,426	60,840
General and administrative	16,802	15,463
Pre-opening expenses	(113)	305
Loss/(gain) on disposal of assets	407	13
Total operating expenses	701,193	674,636
Operating income	38,379	37,295
Other income (expense):		
Interest income	502	178
Interest expense	(1,654)	(1,373)
Other income (expense), net	(928)	(244)
Total other income (expense)	(2,080)	(1,439)
Income before provision for income taxes and income (loss) of unconsolidated affiliates	36,299	35,856
Provision for income taxes	(11,437)	(12,130)
Income (loss) of unconsolidated affiliates	7	(54)
Net income	$ 24,869	23,672
Net income per share available for distribution:		
Basic net income per share	$ 0.82	$ 0.78
Diluted net income per share	$ 0.82	$ 0.78
Shares used in per share computations:		
Basic	29,982	29,890

Diluted	29,987	29,896
Dividends per share	$ —	$ —

See accompanying notes.

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PRICESMART, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Three Months Ended	
	November 30, 2016	November 30, 2015
Net income	$ 24,869	$ 23,672
Other Comprehensive Income, net of tax:		
Foreign currency translation adjustments (1)	$ (10,866)	$ (472)
Defined benefit pension plan:		
Net gain (loss) arising during period	(7)	(4)
Total defined benefit pension plan	(7)	(4)
Derivative instruments: (2)		
Unrealized gains/(losses) on change in fair value of interest rate swaps	492	(120)
Total derivative instruments	492	(120)
Other comprehensive income (loss)	(10,381)	(596)
Comprehensive income	$ 14,488	$ 23,076

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

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

See accompanying notes.

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PRICESMART, INC.

CONSOLIDATED STATEMENTS OF EQUITY

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Common Stock Shares	Amount	Additional Paid-in Capital	Tax Benefit From Stock Based Compensation	Accumulated Other Comprehensive Income(Loss)	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Total Equity
Balance at August 31, 2015	30,978	$ 3	$ 403,168	$ 10,711	$ (101,512)	$ 283,611	793	$ (29,397)	$ 566,584
Issuance of restricted stock award	186	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	2,100	—	—	—	—	—	2,100
Net income	—	—	—	—	—	23,672	—	—	23,672
Other comprehensive income (loss)	—	—	—	—	(596)	—	—	—	(596)
Balance at November 30, 2015	31,164	$ 3	$ 405,268	$ 10,711	$ (102,108)	$ 307,283	793	$ (29,397)	$ 591,760
Balance at August 31, 2016	31,238	$ 3	$ 412,369	$ 11,321	$ (103,951)	$ 351,060	836	$ (32,731)	$ 638,071
Issuance of restricted stock award	5	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	2,442	—	—	—	—	—	2,442
Net income	—	—	—	—	—	24,869	—	—	24,869
Other comprehensive income (loss)	—	—	—	—	(10,381)	—	—	—	(10,381)
Balance at November 30, 2016	31,243	$ 3	$ 414,811	$ 11,321	$ (114,332)	$ 375,929	836	$ (32,731)	$ 655,001

See accompanying notes.

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PRICESMART, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Three Months Ended November 30, 2016	November 30, 2015
Operating Activities:		
Net income	$ 24,869	$ 23,672
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,117	9,203
Allowance for doubtful accounts	7	—
(Gain)/loss on sale of property and equipment	407	13
Deferred income taxes	984	470
Equity in (gains) losses of unconsolidated affiliates	(7)	54
Stock-based compensation	2,442	2,100
Change in operating assets and liabilities:		
Receivables, prepaid expenses and other current assets, accrued salaries and benefits, deferred membership income and other accruals	(6,574)	(10,473)
Merchandise inventories	(44,082)	(55,448)
Accounts payable	12,894	32,291
Net cash provided by (used in) operating activities	2,057	1,882
Investing Activities:		
Additions to property and equipment	(16,973)	(17,708)
Deposits for land purchase option agreements	(500)	—
Proceeds from disposal of property and equipment	108	118
Capital contributions to joint ventures	—	(119)
Net cash provided by (used in) investing activities	(17,365)	(17,709)
Financing Activities:		
Proceeds from long-term bank borrowings	—	7,370
Repayment of long-term bank borrowings	(3,688)	(3,345)
Proceeds from short-term bank borrowings	681	2,255
Repayment of short-term bank borrowings	(4,155)	(6,882)
Net cash provided by (used in) financing activities	(7,162)	(602)
Effect of exchange rate changes on cash and cash equivalents	(1,650)	(637)
Net increase (decrease) in cash and cash equivalents	(24,120)	(17,066)
Cash and cash equivalents at beginning of period	199,522	157,072
Cash and cash equivalents at end of period	$ 175,402	$ 140,006

Supplemental disclosure of cash flow information:
Cash paid during the period for:

Interest, net of amounts capitalized	$ 1,620	$ 1,325
Income taxes	$ 13,704	$ 12,236

See accompanying notes.

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

November 30, 2016

NOTE 1 – COMPANY OVERVIEW AND BASIS OF PRESENTATION

PriceSmart, Inc.'s ("PriceSmart" or the "Company") business consists primarily of international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. As of November 30, 2016, the Company had 39 consolidated warehouse clubs in operation in 12 countries and one U.S. territory (seven in Colombia; six in Costa Rica; five in Panama; four in Trinidad; three in Guatemala, Honduras and the Dominican Republic; two in El Salvador and Nicaragua; and one each in Aruba, Barbados, Jamaica, and the United States Virgin Islands), of which the Company owns 100% of the corresponding legal entities (see Note 2 - Summary of Significant Accounting Policies). The Company constructed a new warehouse club on land acquired in May 2015 in Chia, Colombia that opened in September 2016, fiscal year 2017, bringing the total of warehouse clubs operating in Colombia to seven. In April 2015, the Company acquired land in Managua, Nicaragua. The Company constructed and then opened a warehouse club on this site in November 2015. On December 4, 2015 the Company signed an option to acquire two properties and then swap them for 59,353 square feet of land adjacent to our San Pedro Sula warehouse club in Honduras. The Company exercised this option and completed the swap during May 2016. The Company used the acquired land to expand the parking lot for the San Pedro Sula warehouse club. The expansion was completed in December 2016. The Company continues to explore other potential sites for future warehouse clubs in Central America, the Caribbean and Colombia.

Basis of Presentation - The interim consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2016 (the "2016 Form 10-K"). The interim consolidated financial statements include the accounts of PriceSmart, Inc., a Delaware corporation, and its subsidiaries. Inter-company transactions between the Company and its subsidiaries have been eliminated in consolidation.

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

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation – The interim consolidated financial statements of the Company included herein include the assets, liabilities and results of operations of the Company’s wholly owned subsidiaries and the Company's investment in, and the Company's share of the income (loss) of, joint ventures recorded under the equity method. All significant inter-company accounts and transactions have been eliminated in consolidation. The interim consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the SEC and reflect all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary to fairly present the financial position, results of operations, and cash flows for the periods presented. The results for interim periods are not necessarily indicative of the results for the full year. As of November 30, 2016, all of the Company's subsidiaries were wholly owned. Any reference to the number of properties, square footage or employee numbers are unaudited and outside the scope of our independent registered public accounting firm’s review of our financial statements in accordance with the standards of the United States Public Company Accounting Oversight Board. Additionally, the Company's ownership interest in real estate development joint ventures as of November 30, 2016 is listed below:

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

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

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

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

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

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

	November 30, 2016	August 31, 2016
Short-term restricted cash:		
Restricted cash for land purchase option agreements	$ 442	$ 442
Other short-term restricted cash	75	76
Total short-term restricted cash	$ 517	$ 518
Long-term restricted cash:		
Other long-term restricted cash (1)	$ 2,735	$ 2,676
Total long-term restricted cash	$ 2,735	$ 2,676
Total restricted cash	$ 3,252	$ 3,194

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

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Tax Receivables – The Company pays Value Added Tax (“VAT”) or similar taxes (“input VAT”), income taxes, and other taxes within the normal course of its business in most of the countries in which it operates related to the procurement of merchandise and/or services it acquires and/or on sales and taxable income. The Company also collects VAT or similar taxes on behalf of the government (“output VAT”) for merchandise and/or services it sells. If the output VAT exceeds the input VAT, then 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 and debit card processors to remit a portion of sales processed via credit and debit card directly to the government as advance payments of VAT and/or income tax. In the case of VAT, these procedures alter the natural offset of input and output VAT and generally leave the Company with a net VAT receivable, forcing the Company to process significant refund claims on a recurring basis. With respect to income taxes paid, if the estimated income taxes paid or withheld exceed the actual income tax due, this creates an income tax receivable. The Company either requests a refund of these tax receivables or applies the balance to expected future tax payments. These refund or offset processes can take anywhere from several months to several years to complete.

In most countries where the Company operates, the tax refund process is defined and structured with regular refunds or offsets. However, in three countries there is either not a clearly defined process or the governments have alleged there is not a clearly defined process to allow the authorities to refund VAT receivables. The Company, together with its tax and legal advisers, is currently appealing these interpretations in court and expects to prevail. In one of these countries, where there is recent favorable jurisprudence, the government performed an audit to verify the amount of the VAT receivables as a required precursor to any refund. The balance of the VAT receivables in these countries was $9.2 million and $7.6 million as of November 30, 2016 and August 31, 2016, respectively. In another country in which the Company has warehouse clubs, a new minimum income tax mechanism took effect in fiscal year 2015, 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 November 30, 2016, the Company had deferred tax assets of approximately $1.9 million in this country. Also, the Company had an income tax receivable balance of $3.4 million as of November 30, 2016 related to excess payments from fiscal years 2015 and 2016. The Company has not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets, because the Company believes that it is more likely than not that it will ultimately succeed in its refund requests, related appeals and/or court challenge on this matter.

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

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

- 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):

	November 30, 2016	August 31, 2016
Prepaid expenses and other current assets	$ 1,453	$ 1,635
Other non-current assets	33,584	32,502
Total amount of VAT receivable reported	$ 35,037	$ 34,137

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

	November 30, 2016	August 31, 2016
Prepaid expenses and other current assets	$ 6,985	$ 6,402
Other non-current assets	11,356	10,376
Total amount of income tax receivable reported	$ 18,341	$ 16,778

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

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

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

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

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

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

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

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

Long-term restricted cash: Other long-term restricted cash consists mainly of cash deposits held within banking institutions or with external fund managers in compliance with federal regulatory requirements in Panama to pay a specified benefit on retirement, voluntary departure or death of employees. The carrying value approximates fair value because payments on these plans are not time dependent in nature. Additionally, the Company records as long-term restricted cash amounts deposited in designated banking institutions for other regulatory requirements in Costa Rica.

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

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

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

Long-term debt: The fair value of debt is generally measured using a discounted cash flow analysis based on current market interest rates for similar types of financial instruments. These inputs are not quoted prices in active markets but they are either directly or indirectly observable; therefore, they are classified as Level 2 inputs. The carrying value and fair value of the Company's debt as of November 30, 2016 and August 31, 2016 is as follows (in thousands):

	November 30, 2016		August 31, 2016	
	Carrying Value	Fair Value(1)	Carrying Value	Fair Value(1)
Long-term debt, including current portion	$ 84,452	$ 80,064	$ 88,107	$ 85,654

(1)

The Company has disclosed the fair value of long-term debt, including debt for which it has entered into cross-currency interest rate swaps, using the derivative obligation as of November 30, 2016 and August 31, 2016, to estimate the fair value of long-term debt, which includes the effects that the cross-currency interest rate swaps have had on the fair value of long-term debt.

Derivatives Instruments and Hedging Activities – The Company uses derivative financial instruments for hedging and non-trading purposes to manage its exposure to changes in interest and currency exchange rates. In using derivative financial instruments for the purpose of hedging the Company’s exposure to interest and currency exchange rate risks, the contractual terms of a hedged instrument closely mirror those of the hedged item, providing a high degree of risk reduction and correlation. Contracts that are effective at meeting the risk reduction and correlation criteria (effective hedge) are recorded using hedge accounting. If a derivative financial instrument is an effective hedge, changes in the fair value of the instrument will be offset in accumulated other comprehensive income (loss) until the hedged item completes its contractual term. If any portion of the hedge is deemed ineffective, the change in fair value of the hedged assets or liabilities will be immediately recognized in earnings during the period. Instruments that do not meet the criteria for hedge accounting, or contracts for which the Company has not elected hedge accounting, are valued at fair value with unrealized gains or losses reported in earnings during the period of the change. Valuation techniques utilized in the fair value measurement of assets and liabilities presented on the Company’s consolidated balance sheets were not changed from previous practice during the reporting period. The Company seeks to manage counterparty risk associated with these contracts by limiting transactions to counterparties with which the Company has an established banking relationship. There can be no assurance, however, that this practice effectively mitigates counterparty risk.

Cash Flow Instruments. The Company is a party to receive floating interest rate, pay fixed-rate interest rate swaps to hedge the interest rate risk of certain U.S. dollar denominated debt within its international subsidiaries. The swaps are designated as cash flow hedges of interest expense risk. These instruments are considered effective hedges and are recorded using hedge accounting. The Company is also a party to receive variable interest rate, pay fixed interest rate cross-currency interest rate swaps to hedge the interest rate and currency exposure associated with the expected payments of principal and interest of U.S. denominated debt within its international subsidiaries whose functional currency is other than the U.S. dollar. The swaps are designated as cash flow hedges of the currency risk related to payments on the U.S. denominated debt. These instruments are also considered to be effective hedges and are recorded using hedge accounting. Under cash flow hedging, the effective portion of the fair value of the derivative, calculated as the net present value of the future cash flows, is deferred on the consolidated balance sheets in accumulated other comprehensive loss. If any portion of an interest rate swap is determined to be an ineffective hedge, the gains or losses from changes in fair value would be recorded directly in the consolidated statements of income. Amounts recorded in accumulated other comprehensive loss are released to earnings in the same period that the hedged transaction impacts consolidated earnings. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of interest rate swaps and cross-currency interest rate swaps as of November 30, 2016 and August 31, 2016.

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Fair Value Instruments. The Company is exposed to foreign-currency exchange rate fluctuations in the normal course of business. The Company is also exposed to foreign-currency exchange rate fluctuations on U.S. dollar denominated liabilities within its international subsidiaries whose functional currency is other than the U.S. dollar. The Company manages these fluctuations, in part, through the use of non-deliverable forward foreign-exchange contracts that are intended to offset changes in cash flow attributable to currency exchange movements. The contracts are intended primarily to economically address exposure to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries whose functional currency is other than the U.S. dollar. Currently, these contracts are treated for accounting purposes as fair value instruments and do not qualify for derivative hedge accounting, and as such the Company does not apply derivative hedge accounting to record these transactions. As a result, these contracts are valued at fair value with unrealized gains or losses reported in earnings during the period of the change. The Company seeks to mitigate foreign-currency exchange-rate risk with the use of these contracts and does not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features and are limited to less than one year in duration. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of open, unsettled forward foreign-exchange contracts as of November 30, 2016 and August 31, 2016.

The following tables summarize financial assets and liabilities measured and recorded at fair value on a recurring basis in the Company's consolidated balance sheet as of November 30, 2016 and August 31, 2016 (in thousands) for derivatives that qualify for hedge accounting:

Assets and Liabilities as of November 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other non-current assets – (Cross-currency interest rate swaps)	$ —	$ 3,724	$ —	$ 3,724
Other non-current assets – (Interest rate swaps)	—	439	—	439
Other long-term liabilities – (Interest rate swaps)	—	(222)	—	(222)
Other long-term liabilities – (Cross-currency interest rate swaps)	—	(808)	—	(808)
Total	$ —	$ 3,133	$ —	$ 3,133

Assets and Liabilities as of August 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other non-current assets – (Cross-currency interest rate swaps)	$ —	$ 3,224	$ —	$ 3,224
Other long-term liabilities – (Interest rate swaps)	—	(448)	—	(448)
Other long-term liabilities – (Cross-currency interest rate swaps)	—	(1,066)	—	(1,066)
Total	$ —	$ 1,710	$ —	$ 1,710

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following tables summarize financial assets and liabilities measured and recorded at fair value on a recurring basis in the Company's consolidated balance sheet as of November 30, 2016 and August 31, 2015 (in thousands) for derivatives that do not qualify for hedge accounting:

Assets and Liabilities as of November 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other accrued expenses (Foreign currency forward contracts)	$ —	$ (153)	$ —	$ (153)
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting	$ —	$ (153)	$ —	$ (153)

Assets and Liabilities as of August 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other accrued expenses (Foreign currency forward contracts)	$ —	$ (110)	$ —	$ (110)
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting	$ —	$ (110)	$ —	$ (110)

Goodwill – The table below presents goodwill resulting from certain business combinations as of November 30, 2016 and August 31, 2016 (in thousands). The change in goodwill is a result of foreign exchange translation losses.

	November 30, 2016	August 31, 2016	Change
Goodwill	$ 35,603	$ 35,637	$ (34)

The Company reviews goodwill at the reporting unit for impairment. The Company first reviews qualitative factors for each reporting unit in determining if an annual goodwill test is required. If the Company's review of qualitative factors indicates a requirement for a test of goodwill impairment, because it is more likely than not that an impairment of goodwill may exist, the Company then will assess whether the carrying amount of a reporting unit is greater than the estimated fair value. If the carrying amount of a reporting unit is greater than zero and its estimated fair value exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If either the carrying amount of the reporting unit is not greater than zero or if the carrying amount of the entity exceeds its estimated fair value, the Company performs a second test to determine whether goodwill has been impaired and to calculate the amount of that impairment. The Company was not required to perform the second step for any reporting units in 2016 or 2015.

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

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

income. The Company has determined that breakage revenue is insignificant; therefore, it records 100% of the Platinum membership liability at the time of sale, rather than estimating breakage.

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

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

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

The Company’s Guatemala Pradera warehouse club experienced a fire in its merchandise receiving department during the early morning hours of June 4, 2015. No members or employees were in the warehouse club at the time. The fire was extinguished, but caused considerable smoke and some fire damage. The warehouse club was closed for nine days and reopened on June 13, 2015. The Company is insured for these costs and filed an insurance claim with its insurance provider. As of August 31, 2015, the Company's receivable related to this insurance claim was approximately $2.6 million. The Company’s insurance policy also addresses coverage for business interruption. During the fourth quarter of fiscal year 2015, the Company filed a claim with its insurance carrier for approximately $332,000 related to business interruption for which the Company did not record a receivable.

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

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

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

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

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

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

The following table summarizes the amounts recorded for the three months ended November 30, 2016 and 2015 (in thousands):

	Three Months Ended	
	November 30, 2016	November 30, 2015
Currency gain (loss)	$ (928)	$ (244)

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

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company accrues an amount for its estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained. This requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. When facts and circumstances change, the Company reassesses these probabilities and records any changes in the consolidated financial statements as appropriate. There were no material changes in the Company's uncertain income tax positions as of November 30, 2016 and August 31, 2016. During the first quarter of fiscal year 2015, one of the Company's subsidiaries received provisional assessments claiming $2.5 million of taxes, penalties and interest related to withholding taxes on certain charges for services rendered by the Company. In addition, this subsidiary received provisional assessments totaling $5.2 million for lack of deductibility of the underlying service charges due to the lack of withholding. Based on a review of the Company's tax advisers' interpretation of local law, rulings and jurisprudence (including Supreme Court precedents with respect to the deductibility assessment), the Company expects to prevail in both instances and has not recorded a provision for these assessments. Also, in another country where the Company operates, 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 appealed) do not clearly allow the Company to obtain a refund or offset this excess income tax against other taxes. As of November 30, 2016, the Company had deferred tax assets of approximately $1.9 million in this country. Also, the Company had an income tax receivable balance of $3.4 million as of November 30, 2016 related to excess payments from fiscal years 2015 and 2016. The Company has not placed any type of allowance on the recoverability of these tax receivables or deferred income taxes, because the Company believes that it is more likely than not that it will succeed in its appeal on this matter.

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

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

	Three Months Ended	
	November 30,	November 30,

	2016	2015	
Federal tax provision at statutory rates	35.0 %	35.0	%
State taxes, net of federal benefit	0.3	0.4	
Differences in foreign tax rates	(4.5)	(4.7)	
Permanent items and other adjustments	0.8	2.0	
Increase (decrease) in foreign valuation allowance	(0.1)	1.1	
Provision for income taxes	31.5 %	33.8	%

For the three months ended November 30, 2016, the effective tax rate was 31.5%. The decrease in the effective tax rate versus the prior year was primarily attributable to an intercompany transaction between PriceSmart, Inc. and our Colombian subsidiary in support of PriceSmart's ongoing market development and growth in Colombia. This intercompany transaction resulted in a favorable impact on the effective tax rate of 1.4% due to reductions to taxable income in the U.S. and a resulting increase in taxable income in our Colombia subsidiary. This income did not generate income tax expense in Colombia because the additional taxable income in Colombia was fully offset by the reversal of valuation allowances on accumulated net losses in that subsidiary. We expect a similar favorable impact to the consolidated Company's effective tax rate over the next several quarters. Additionally, in comparison to the prior year, there was a favorable impact of 0.6% resulting from improved financial results in the Company's Colombia subsidiary for which no resulting change in tax expense was recognized, net of adjustment to valuation allowance.

Recent Accounting Pronouncements

FASB ASC 230 ASU 2016-18- Statement of Cash Flows (Topic 230)—Restricted Cash

In November 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-18, Statement of Cash Flows (Topic 230)—Restricted Cash. This ASU addresses the diversity in practice that exists regarding the classification and the presentation of changes in restricted cash on the statement of cash flows.

The amendments in ASU No. 2016-18 require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. Thus, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and the end-of-period total amounts set forth on the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2017 and interim periods within those fiscal years and will be applied using a retrospective transition method to each period presented. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

FASB ASC 740 ASU 2016-16- Income Taxes (Topic 740)—Intra-Entity Transfers of Assets Other Than Inventory

In October 2016, the FASB issued Accounting Standards Update (“ASU”) No. 2016-16, Income Taxes (Topic 740)—Intra-Entity Transfers of Assets Other Than Inventory. Currently, U.S. GAAP prohibits recognizing current and deferred income tax consequences for an intra-entity asset transfer until the asset has been sold to an outside party. ASU 2016-16 states that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs.

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 amendments should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

FASB ASC 230 ASU 2016-15- Statement of Cash Flows (Topic 230)—Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force)

In August 2016, the FASB issued Accounting Standards Update (“ASU”) No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU addresses stakeholders’ concerns regarding diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. In particular, ASU No. 2016-15 addresses eight specific cash flow issues in an effort to reduce this diversity in practice: (1) debt prepayment or debt extinguishment costs; (2) settlement of zero-coupon bonds; (3) contingent consideration payments made after a business combination; (4) proceeds from the settlement of insurance claims; (5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (6) distributions received from equity method investees; (7) beneficial interests in securitization transactions; and (8) separately identifiable cash flows and application of the predominance principle.

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 amendments in this ASU should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

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

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

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

The amendments in this ASU are effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted in any interim or annual period.

Amendments related to the timing of when excess tax benefits are recognized, minimum statutory withholding requirements, forfeitures, and intrinsic value should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. Amendments related to the presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet the minimum statutory withholding requirement should be applied retrospectively. Amendments requiring recognition of excess tax benefits and tax deficiencies in the income statement and the practical expedient for estimating expected term should be applied prospectively. An entity may elect to apply the amendments related to the presentation of excess tax benefits on the statement of cash flows using either a prospective transition method or a retrospective transition method.

The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

FASB ASC 405 ASU 2016-04 Liabilities-Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Cards

On March 8, 2016, the FASB issued Accounting Standards Update 2016-04, Recognition of Breakage for Certain Prepaid Stored-Value Products, a consensus of the FASB’s Emerging Issues Task Force. The new guidance creates an exception under ASC 405-20, Liabilities – Extinguishments of Liabilities, to derecognize financial liabilities related to certain prepaid stored-value products using a revenue-like breakage model.

Prepaid stored-value products are products with stored monetary value that can be redeemed for goods, services, and/or cash (e.g., gift cards). The issuers frequently experience breakage whereby consumers do not redeem the entire balance of their prepaid stored-value cards.

The new guidance requires issuers that record financial liabilities related to prepaid stored-value products to follow the same breakage model required by ASC 606, Revenue from Contracts with Customers for non-financial liabilities. If an entity expects to be entitled to a breakage amount for a liability resulting from the sale of a prepaid stored-value card, the entity shall derecognize the amount related to the expected breakage in proportion to the pattern of rights expected to be exercised by the card holder only to the extent that it is probable that a significant reversal of the recognized breakage amount will not subsequently occur. If an entity does not expect to be entitled to a breakage amount for prepaid stored-value cards, the entity shall derecognize the amount related to breakage when the likelihood of the customer exercising its remaining rights becomes remote.

The amendments in this ASU are effective on a prospective or retrospective basis for public entities for fiscal years and interim periods within those annual periods beginning after December 15, 2017. 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 842 ASU 2016-02 -Leases (Topic 842): Amendments to the FASB Accounting Standards Codification

In February 2016, the FASB issued amendments to the guidance on lease accounting. Under the new guidance, for all leases longer than 12 months, a lessee will be required to record a lease liability for all payments arising from a lease and also record a right of use asset for the term of the lease. Under the new guidance lessor accounting is largely unchanged.

The amendment in this ASU is effective on a prospective or modified retrospective basis for public entities for fiscal years and interim periods within those annual periods beginning after December 15, 2018. Early adoption is permitted. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. These practical expedients relate to the identification and classification of leases that commenced before the effective date, initial direct costs for leases that commenced before the effective date, and the ability to use hindsight in evaluating lessee options to extend or terminate a lease or to purchase the underlying asset. An entity that elects to apply the practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP.

The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

FASB ASC 740 ASU 2015-17 -Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes

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

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The amendment in this ASU is effective on a prospective or retrospective basis for public entities for fiscal years and interim periods within those annual periods beginning after December 15, 2016. Early adoption is allowed. The Company retrospectively adopted this amendment to the guidance during the second quarter of fiscal year 2016, and now presents all deferred taxes as either long-term assets or long-term liabilities. The Company disclosed within its Annual Report on Form 10-K filed for fiscal year 2016 and within the Quarterly Reports on Form 10-Q for the quarterly periods for fiscal year 2016 the financial impact to the Consolidated Balance Sheet.

FASB ASC 330 ASU 2015-11 -Inventory (Topic 330): Simplifying the Measurement of Inventory

In July 2015, the FASB issued guidance that will require an entity to measure in-scope inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This amendment applies to entities, like the Company, that measure inventory value using the average cost method. The amendments in this ASU more closely align the measurement of inventory in GAAP with the measurement of inventory in International Financial Reporting Standards.

The amendment in this ASU is effective on a prospective basis for public entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early application is permitted as of the beginning of an interim or annual reporting period. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

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

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

The amendments in this ASU are effective for public entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption was permitted. An entity was able to adopt the amendments either: (1) prospectively to all arrangements entered into or materially modified after the effective date; or (2) retrospectively. The Company adopted this amended guidance as of September 1, 2016. Adoption of this guidance did not generate a change in accounting principle, changes in financial statement line items, or the requirement to prospectively or retrospectively adopt a method of transition.

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

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

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

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

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 3 – PROPERTY AND EQUIPMENT

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

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

	November 30, 2016	August 31, 2016
Land	$ 129,649	$ 131,896
Building and improvements	325,757	305,420
Fixtures and equipment	191,910	186,409
Construction in progress	26,748	46,861
Total property and equipment, historical cost	674,064	670,586
Less: accumulated depreciation	(204,641)	(197,541)
Property and equipment, net	$ 469,423	$ 473,045

Depreciation and amortization expense (in thousands):

	Three Months Ended	
	November 30, 2016	November 30, 2015
Depreciation and amortization expense	$ 11,117	$ 9,203

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

Total interest capitalized (in thousands):

	Balance as of	
	November 30, 2016	August 31, 2016
Total interest capitalized	$ 7,972	$ 7,380

Total interest capitalized (in thousands):

	Three Months Ended	
	November 30, 2016	November 30, 2015
Interest capitalized	$ 188	$ 294

The Company constructed a new warehouse club on land acquired in May 2015 in Chia, Colombia that opened in September 2016, fiscal year 2017 bringing the total of warehouse clubs operating in Colombia to seven. On December 4, 2015, the Company signed an option to acquire two properties and then swap them for 59,353 square feet of land adjacent to the Company's San Pedro Sula warehouse club in Honduras. The parcels of land exchanged are all undeveloped contiguous land parcels that make them similar in all respects. The transaction was completely nonmonetary in nature, and the transaction did

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not generate any gain recognition. The accounting basis of the new property equals $1.9 million (the net book value of the real estate exchanged). The Company exercised this option and completed the swap during May 2016. The Company used the acquired land to expand the parking lot for the San Pedro Sula warehouse club.

In March 2016, the Company entered into a contract, subject to customary contingencies, to acquire a distribution center in Medley, Miami-Dade County, Florida, we will transfer the majority of our current Miami distribution center activities once the construction of the building is complete and the building is ready for occupancy. The Company expects construction to be completed in first half of calendar 2017.

The Company also recorded within other accrued expenses approximately $2.5 million as of November 30, 2016 and recorded within accounts payable and other accrued expenses approximately $280,000 and $1.7 million as of August 31, 2016 of liabilities related to the acquisition and/or construction of property and equipment, respectively.

NOTE 4 – EARNINGS PER SHARE

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

The following table sets forth the computation of net income per share for the three months ended November 30, 2016 (in thousands, except per share amounts):

	Three Months Ended	
	November 30, 2016	November 30, 2015
Net income	$ 24,869	$ 23,672
Less: Allocation of income to unvested stockholders	(420)	(334)
Net earnings available to common stockholders	$ 24,449	$ 23,338
Basic weighted average shares outstanding	29,982	29,890
Add dilutive effect of stock options (two-class method)	5	6
Diluted average shares outstanding	29,987	29,896
Basic net income per share	$ 0.82	$ 0.78
Diluted net income per share	$ 0.82	$ 0.78

NOTE 5 – STOCKHOLDERS' EQUITY

Dividends

No dividends were declared by the Company's Board of Directors during the first three months of fiscal year 2017. The following table summarizes the dividends declared and paid during fiscal year 2016.

		First Payment			Second Payment		
Declared	Amount	Record Date	Date Paid	Amount	Record Date	Date Paid	Amount
2/3/2016	$ 0.70	2/15/2016	2/29/2016	$ 0.35	8/15/2016	8/31/2016	$ 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.

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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):

	Three Months Ended November 30, 2016				
	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments		Total
Beginning balance, September 1, 2016	$ (102,242)	$ (315)	$ (1,394)	(1)	$ (103,951)
Other comprehensive income (loss)	(10,866)	(7)	492		(10,381)
Ending balance, November 30, 2016	$ (113,108)	$ (322)	$ (902)		$ (114,332)

	Three Months Ended November 30, 2015				
	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments		Total
Beginning balance, September 1, 2015	$ (100,540)	$ (113)	$ (859)		$ (101,512)
Other comprehensive income (loss)	(472)	(4)	(120)	(1)	(596)
Ending balance, November 30, 2015	$ (101,012)	$ (117)	$ (979)		$ (102,108)

	Twelve Months Ended August 31, 2016						
	Foreign currency translation adjustments	Defined benefit pension plans		Derivative Instruments		Total
Beginning balance, September 1, 2015	$ (100,540)	$ (113)		$ (859)		$ (101,512)
Other comprehensive income (loss)	(1,702)	(182)		(535)	(1)	(2,419)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(20)	(2)	—		(20)
Ending balance, August 31, 2016	$ (102,242)	$ (315)		$ (1,394)		$ (103,951)

(1) See Note 9 - Derivative Instruments and Hedging Activities.
(2) Amounts reclassified from accumulated other comprehensive income (loss) related to the minimum pension liability are included in warehouse club operations in the Company's Consolidated Statements of Income.

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):

	November 30, 2016	August 31, 2016
Retained earnings not available for distribution	$ 6,036	$ 5,926

NOTE 6 – STOCK BASED COMPENSATION

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

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

capital and the tax deficiency resulting from stock-based compensation in excess of the related tax deduction as a reduction in paid-in capital, based on the Tax Law Ordering method. In addition, the Company reflects the tax savings (deficiency) resulting from the taxation of stock-based compensation as a financing cash flow in its consolidated statement of cash flows, rather than as operating cash flows.

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

The Company adopted the 2013 Equity Incentive Award Plan (the "2013 Plan") for the benefit of its eligible employees, consultants and non-employee directors on January 22, 2013. The 2013 Plan provides for awards covering up to (1) 600,000 shares of common stock plus (2) the number of shares that remained available for issuance as of January 22, 2013 under three equity participation plans previously maintained by the Company. The number of shares reserved for issuance under the 2013 Plan increases during the term of the plan by the number of shares relating to awards outstanding under the 2013 Plan or certain prior plans that expire, or are forfeited, terminated, canceled or repurchased, or are settled in cash in lieu of shares. However, in no event will more than an aggregate of 1,141,769 shares of the Company's common stock be issued under the 2013 Plan.

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

	Shares authorized for issuance as of November 30, 2016 (including shares originally authorized for issuance under prior plans)	Shares available to grant	
		November 30, 2016	August 31, 2016
2013 Plan	925,896	606,118	615,889

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

	Three Months Ended	
	November 30, 2016	November 30, 2015
Options granted to directors	$ 18	$ 25
Restricted stock awards	1,871	1,701
Restricted stock units		