

Container Store Group, Inc.
Form 10-Q
January 07, 2016
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the Quarterly Period Ended November 28, 2015

OR

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

For the transition period from _____ to _____

Commission File Number: 001-36161

THE CONTAINER STORE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

26-0565401
(IRS Employer Identification No.)

Edgar Filing: Container Store Group, Inc. - Form 10-Q

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

75019
(Zip Codes)

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

None

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer 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.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

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 47,986,975 shares of its common stock outstanding as of December 23, 2015.

Table of Contents

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1.	<u>Financial Statements</u>	
	<u>Consolidated Balance Sheets as of November 28, 2015, February 28, 2015, and November 29, 2014</u>	3
	<u>Consolidated Statements of Operations for the Thirteen and Thirty-Nine Weeks Ended November 28, 2015 and November 29, 2014</u>	5
	<u>Consolidated Statements of Comprehensive Income (Loss) for the Thirteen and Thirty-Nine Weeks ended November 28, 2015 and November 29, 2014</u>	6
	<u>Consolidated Statements of Cash Flows for the Thirty-Nine Weeks ended November 28, 2015 and November 29, 2014</u>	7
	<u>Notes to the Consolidated Financial Statements</u>	8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	32
Item 4.	<u>Controls and Procedures</u>	32

PART II. OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	32
Item 1A.	<u>Risk Factors</u>	32
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	32
Item 3.	<u>Default Upon Senior Securities</u>	33
Item 4.	<u>Mine Safety Disclosures</u>	33
Item 5.	<u>Other Information</u>	33
Item 6.	<u>Exhibits</u>	33

Table of Contents**The Container Store Group, Inc.****Consolidated balance sheets**

	November 28, 2015	February 28, 2015	November 29, 2014
(In thousands)	(unaudited)		(unaudited)
Assets			
Current assets:			
Cash	\$14,571	\$24,994	\$13,965
Accounts receivable, net	24,170	24,319	24,036
Inventory	109,296	83,724	103,850
Prepaid expenses	8,438	7,895	9,259
Income taxes receivable	1,637	1,698	3,205
Deferred tax assets, net	3,256	3,256	3,967
Other current assets	11,584	11,056	14,589
Total current assets	172,952	156,942	172,871
Noncurrent assets:			
Property and equipment, net	175,239	169,053	168,859
Goodwill	202,815	202,815	202,815
Trade names	227,659	229,433	234,557
Deferred financing costs, net	6,540	7,742	8,231
Noncurrent deferred tax assets, net	2,285	1,739	1,055
Other assets	1,703	1,333	1,178
Total noncurrent assets	616,241	612,115	616,695
Total assets	\$789,193	\$769,057	\$789,566

See accompanying notes.

Table of Contents**The Container Store Group, Inc.****Consolidated balance sheets (continued)**

	November 28, 2015	February 28, 2015	November 29, 2014
	(unaudited)		(unaudited)
(In thousands, except share and per share amounts)			
Liabilities and shareholders' equity			
Current liabilities:			
Accounts payable	\$50,435	\$48,904	\$50,163
Accrued liabilities	57,744	59,891	54,837
Revolving lines of credit	8,415	2,834	10,250
Current portion of long-term debt	5,239	5,319	5,332
Income taxes payable	300	2,188	1,377
Deferred tax liabilities, net	-	-	29
Total current liabilities	122,133	119,136	121,988
Noncurrent liabilities:			
Long-term debt	350,950	326,775	348,489
Noncurrent deferred tax liabilities, net	81,200	82,965	84,101
Deferred rent and other long-term liabilities	38,357	38,319	38,657
Total noncurrent liabilities	470,507	448,059	471,247
Total liabilities	592,640	567,195	593,235
Commitments and contingencies (Note 7)			
Shareholders' equity:			
Common stock, \$0.01 par value, 250,000,000 shares authorized; 47,986,975 shares issued and outstanding at November 28, 2015; 47,983,660 shares issued and outstanding at February 28, 2015; 47,981,512 shares issued and outstanding at November 29, 2014	480	480	480
Additional paid-in capital	856,515	855,322	855,038
Accumulated other comprehensive loss	(20,587)	(18,342)	(10,541)
Retained deficit	(639,855)	(635,598)	(648,646)
Total shareholders' equity	196,553	201,862	196,331
Total liabilities and shareholders' equity	\$789,193	\$769,057	\$789,566

See accompanying notes.

Table of Contents**The Container Store Group, Inc.****Consolidated statements of operations**

(In thousands, except share and per share amounts) (unaudited)	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 28, 2015	November 29, 2014	November 28, 2015	November 29, 2014
Net sales	\$197,241	\$190,922	\$562,556	\$557,607
Cost of sales (excluding depreciation and amortization)	81,137	77,063	233,299	229,230
Gross profit	116,104	113,859	329,257	328,377
Selling, general, and administrative expenses (excluding depreciation and amortization)	101,949	93,842	289,469	275,015
Stock-based compensation	487	404	1,164	950
Pre-opening costs	2,994	1,597	6,870	6,943
Depreciation and amortization	8,834	7,776	25,249	22,599
Other expenses	-	363	-	1,170
Loss (gain) on disposal of assets	52	(3,879)	64	(3,665)
Income from operations	1,788	13,756	6,441	25,365
Interest expense	4,213	4,265	12,611	12,950
(Loss) income before taxes	(2,425)	9,491	(6,170)	12,415
(Benefit) provision for income taxes	(694)	3,242	(1,913)	2,790
Net (loss) income	\$(1,731)	\$6,249	\$(4,257)	\$9,625
Net (loss) income per common share - basic and diluted	\$(0.04)	\$0.13	\$(0.09)	\$0.20
Weighted-average common shares outstanding - basic	47,986,975	47,979,581	47,985,298	47,967,566
Weighted-average common shares outstanding - diluted	47,986,975	48,432,143	47,985,298	48,555,828

See accompanying notes.

Table of Contents**The Container Store Group, Inc.****Consolidated statements of comprehensive income (loss)**

(In thousands) (unaudited)	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 28, 2015	November 29, 2014	November 28, 2015	November 29, 2014
Net (loss) income	(\$1,731)	\$6,249	(\$4,257)	\$9,625
Unrealized gain (loss) on financial instruments, net of tax provision (benefit) of \$159, \$(361), \$564, and \$(584)	248	(560)	874	(946)
Pension liability adjustment	41	87	62	207
Foreign currency translation adjustment	(2,330)	(5,525)	(3,181)	(11,485)
Comprehensive (loss) income	\$(3,772)	\$251	\$(6,502)	\$(2,599)

See accompanying notes.

Table of Contents**The Container Store Group, Inc.****Consolidated statements of cash flows**

(In thousands) (unaudited)	Thirty-Nine Weeks Ended	
	November 28, 2015	November 29, 2014
Operating activities		
Net (loss) income	\$(4,257)	\$9,625
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	25,249	22,599
Stock-based compensation	1,164	950
Excess tax benefit from stock-based compensation	-	(90)
Loss (gain) on disposal of assets	64	(3,665)
Deferred tax (benefit) expense	(2,806)	1,249
Noncash interest	1,460	1,467
Other noncash items	181	-
Changes in operating assets and liabilities:		
Accounts receivable	(1,153)	5,101
Inventory	(24,931)	(21,048)
Prepaid expenses and other assets	(1,093)	(460)
Accounts payable and accrued liabilities	3,871	3,149
Income taxes	(1,948)	(4,660)
Other noncurrent liabilities	422	1,447
Net cash (used in) provided by operating activities	(3,777)	15,664
Investing activities		
Additions to property and equipment	(36,446)	(40,359)
Proceeds from investment grant	479	-
Proceeds from sale of subsidiary, net	-	3,846
Proceeds from sale of property and equipment	199	935
Net cash used in investing activities	(35,768)	(35,578)
Financing activities		
Borrowings on revolving lines of credit	46,222	60,374
Payments on revolving lines of credit	(40,354)	(64,223)
Borrowings on long-term debt	33,000	34,748
Payments on long-term debt	(8,981)	(15,319)
Payment of debt issuance costs	(258)	-
Proceeds from the exercise of stock options	59	704
Excess tax benefit from stock-based compensation	-	90
Net cash provided by financing activities	29,688	16,374
Effect of exchange rate changes on cash	(566)	(541)
Net decrease in cash	(10,423)	(4,081)
Cash at beginning of period	24,994	18,046
Cash at end of period	\$14,571	\$13,965
Supplemental disclosures of non-cash activities:		
Purchases of property and equipment (included in accounts payable)	\$2,060	\$1,464
Capital lease obligation incurred	\$374	\$-

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Notes to consolidated financial statements (unaudited)

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

November 28, 2015

1. Description of business and basis of presentation

These financial statements should be read in conjunction with the financial statement disclosures in our Annual Report on Form 10-K for the fiscal year ended February 28, 2015, filed with the Securities and Exchange Commission on May 8, 2015. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). We use the same accounting policies in preparing quarterly and annual financial statements. All adjustments necessary for a fair presentation of quarterly operating results are reflected herein and are of a normal, recurring nature.

Description of business

The Container Store, Inc. was founded in 1978 in Dallas, Texas, as a retailer with a mission to provide customers with storage and organization solutions through an assortment of innovative products and unparalleled customer service. In 2007, The Container Store, Inc. was sold to The Container Store Group, Inc. (the Company), a holding company, of which a majority stake was purchased by Leonard Green and Partners, L.P. (LGP), with the remainder held by certain employees of The Container Store, Inc. On November 6, 2013, the Company completed its initial public offering (the IPO). As the majority shareholder, LGP retains controlling interest in the Company. The Container Store, Inc. consists of our retail stores, website and call center, as well as our installation and organizational services business. As of November 28, 2015, The Container Store, Inc. operated 77 stores with an average size of approximately 25,000 square feet (19,000 selling square feet) in 28 states and the District of Columbia. The Container Store, Inc. s wholly owned Swedish subsidiary, Elfa International AB (Elfa) designs and manufactures component-based shelving and drawer systems and made-to-measure sliding doors. elfa® branded products are sold exclusively in the United States in The Container Store retail stores, website and call center, and Elfa sells to various retailers on a wholesale basis in approximately 30 countries around the world, with a concentration in the Nordic region of Europe.

Seasonality

The Company s business is moderately seasonal in nature and, therefore, the results of operations for the thirty-nine weeks ended November 28, 2015 are not necessarily indicative of the operating results for the full year. Demand is generally highest in the fourth fiscal quarter due to Our Annual elfa® Sale, and lowest in the first fiscal quarter.

Reclassifications

Certain prior period amounts have been reclassified in order to provide consistent comparative information. These reclassifications do not materially impact the consolidated financial statements for the prior periods presented.

Recent accounting pronouncements

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-17, *Balance Sheet Classification of Deferred Taxes*. The update requires an entity to classify deferred tax liabilities and assets as noncurrent within a classified statement of financial position. ASU 2015-17 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2016, with early adoption permitted. This update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively

Table of Contents

to all periods presented. The Company does not believe the implementation of this standard will result in a material impact to its financial statements and will early adopt the guidance at the end of its fourth quarter of fiscal year 2015.

In July 2015, the FASB issued ASU 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*, which changes the measurement principle for inventory from the lower of cost or market to the lower of cost and net realizable value. ASU 2015-11 defines net realizable value as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The new guidance must be applied on a prospective basis and is effective for fiscal years beginning after December 15, 2015, and interim periods within those years, with early adoption permitted. The Company does not believe the implementation of this standard will result in a material impact to its financial statements.

In April 2015, the FASB issued ASU 2015-05, *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer Accounting for Fees Paid in a Cloud Computing Arrangement*. The amendments in ASU 2015-05 provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with 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 in ASU 2015-05 are effective for fiscal years beginning after December 15, 2015, and interim periods within those years, with early adoption permitted. The guidance may be applied either prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. The Company does not believe the implementation of this standard will result in a material impact to its financial statements.

In April 2015, the FASB issued ASU 2015-03, *Interest Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs*. The update requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability instead of being presented as an asset. Debt disclosures will include the face amount of the debt liability and the effective interest rate. The update requires retrospective application and represents a change in accounting principle. ASU 2015-03 is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. In addition, in August 2015, ASU 2015-15, *Interest Imputation of Interest* was released which added SEC paragraphs pursuant to the SEC Staff Announcement at the June 18, 2015 Emerging Issues Task Force (EITF) meeting about the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements. Given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, ASU 2015-15 states the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The impact of ASU 2015-03 and ASU 2015-15 on our consolidated financial statements will include a reclassification of net deferred financing costs related to our Senior Secured Term Loan Facility to be presented in the balance sheet as a direct deduction from the carrying amount of the Senior Secured Term Loan Facility, while net deferred financing costs related to our Revolving Credit Facility will remain an asset. As of November 28, 2015, the Company had \$6,106 of net deferred financing costs related to our Senior Secured Term Loan Facility.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, an updated standard on revenue recognition. ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using IFRS and GAAP. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. In July 2015, the FASB deferred the effective date of ASU 2014-09. Accordingly, this standard is effective for reporting periods beginning

Table of Contents

after December 15, 2017, including interim periods within that fiscal year, with early adoption permitted for interim and annual periods beginning after December 15, 2016. The Company is still evaluating the impact of implementation of this standard on its financial statements.

2. Long-term debt and revolving lines of credit

On October 8, 2015, The Container Store, Inc. executed an amendment (Amendment No. 2) to its revolving credit facility (the Revolving Credit Facility). Under the terms of Amendment No. 2, among other items, (i) the maturity date of the loan was extended from April 6, 2017 to the earlier of (x) October 8, 2020 and (y) January 6, 2019, if any of The Container Store, Inc.'s obligations under its term loan credit facility remain outstanding on such date and have not been refinanced with debt that has a final maturity date that is no earlier than April 6, 2019 or subordinated debt, (ii) the aggregate principal amount of the facility was increased from \$75,000 to \$100,000, (iii) the interest rate decreased from a range of LIBOR + 1.25% to 1.75% to LIBOR + 1.25% and (iv) the uncommitted incremental revolving facility was increased from \$25,000 to \$50,000, which is subject to receipt of lender commitments and satisfaction of specified conditions.

As provided in Amendment No. 2, the Revolving Credit Facility will continue to be used for working capital and other general corporate purposes. Amendment No. 2 allows for swing line advances of up to \$15,000 and the issuance of letters of credit of up to \$40,000, increased from the previous swing line limits of \$7,500 and letter of credit limits of \$25,000.

The Company capitalizes certain costs associated with issuance of various debt instruments. These deferred financing costs are amortized to interest expense on a straight-line method, which is materially consistent with the effective interest method, over the terms of the related debt agreements. The Company capitalized \$258 of fees associated with Amendment No. 2 that will be amortized through October 8, 2020.

3. Detail of certain balance sheet accounts

	November 28, 2015	February 28, 2015	November 29, 2014
Inventory:			
Finished goods	\$104,538	\$79,073	\$98,460
Raw materials	4,416	3,501	4,260
Work in progress	342	1,150	1,130
	\$109,296	\$83,724	\$103,850
Accrued liabilities:			
Accrued payroll, benefits, and bonuses	\$17,569	\$20,155	\$17,865
Accrued transaction and property tax	11,813	8,503	11,083
Gift cards and store credits outstanding	8,158	7,683	8,192
Unearned revenue	5,603	11,385	3,649
Accrued lease liabilities	4,185	3,920	3,658
Accrued interest	2,345	2,333	2,451
Other accrued liabilities	8,071	5,912	7,939
	\$57,744	\$59,891	\$54,837

Table of Contents**4. Net income (loss) per common share**

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

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

	November 28, 2015	Thirteen Weeks Ended November 29, 2014	November 28, 2015	Thirty-Nine Weeks Ended November 29, 2014
Numerator:				
Net (loss) income	\$(1,731)	\$6,249	\$(4,257)	\$9,625
Denominator:				
Weighted-average common shares outstanding basic	47,986,975	47,979,581	47,985,298	47,967,566
Weighted-average common shares outstanding diluted	47,986,975	48,432,143	47,985,298	48,555,828
Net (loss) income per common share - basic and diluted	\$(0.04)	\$0.13	\$(0.09)	\$0.20
Antidilutive securities not included:				
Stock options outstanding	2,907,034	843,581	2,870,248	812,886

5. Pension plans

The Company provides pension benefits to the employees of Elfa under collectively bargained pension plans in Sweden, which are recorded in other long-term liabilities. The defined benefit plan provides benefits for participating employees based on years of service and final salary levels at retirement. The defined benefit plans are unfunded and approximately 3% of Elfa employees are participants in the defined benefit pension plan. Certain employees also participate in defined contribution plans for which Company contributions are determined as a percentage of participant compensation. The Company contributed \$593 and \$893 for defined contribution plans in the thirteen weeks ended November 28, 2015 and November 29, 2014, respectively. The Company contributed \$1,744 and \$2,207 for defined contribution plans in the thirty-nine weeks ended November 28, 2015 and November 29, 2014, respectively.

6. Income taxes

Edgar Filing: Container Store Group, Inc. - Form 10-Q

The Company's effective income tax rate for the thirteen weeks ended November 28, 2015 was 28.6% compared to 34.2% for the thirteen weeks ended November 29, 2014. In the third quarter of fiscal 2015, the effective tax rate fell below the U.S. statutory rate primarily due to the mix of permanently reinvested foreign earnings that are subject to lower foreign tax rates. In the third quarter of fiscal 2014, the effective tax rate fell below the U.S. statutory rate primarily due to a non-taxable gain on the sale of a Norwegian subsidiary and the mix of permanently reinvested foreign earnings that are subject to lower foreign tax rates.

The Company's effective income tax rate for the thirty-nine weeks ended November 28, 2015 was 31.0% compared

Table of Contents

to 22.5% for the thirty-nine weeks ended November 29, 2014. During the first thirty-nine weeks of fiscal 2015, the effective tax rate fell below the U.S. statutory rate primarily due to the mix of permanently reinvested foreign earnings that are subject to lower foreign tax rates. During the first thirty-nine weeks of fiscal 2014, the effective tax rate fell below the U.S. statutory rate primarily due to a \$1.8 million reduction in tax expense recorded in the second quarter of fiscal 2014 related to a refund of tax paid in a prior period, a non-taxable gain on the sale of a Norwegian subsidiary recorded in the third quarter of fiscal 2014, and the mix of permanently reinvested foreign earnings that are subject to lower foreign tax rates.

7. Commitments and contingencies

In connection with insurance policies and other contracts, the Company has outstanding standby letters of credit totaling \$3,598 as of November 28, 2015.

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

8. Accumulated other comprehensive income

Accumulated other comprehensive income (AOCI) consists of changes in our foreign currency forward contracts, pension liability adjustment, and foreign currency translation. The components of AOCI, net of tax, are shown below for the thirty-nine weeks ended November 28, 2015:

	Foreign currency forward contracts	Pension liability adjustment	Foreign currency translation	Total
Balance at February 28, 2015	\$(882)	\$(1,167)	\$(16,293)	\$(18,342)
Other comprehensive (loss) income before reclassifications, net of tax	(95)	62	(3,181)	(3,214)
Amounts reclassified to earnings, net of tax	969	-	-	969
Net current period other comprehensive income (loss)	874	62	(3,181)	(2,245)

Balance at November 28, 2015

\$(8)	\$(1,105)	\$(19,474)	\$(20,587)
-------	-----------	------------	------------

Amounts reclassified from AOCI to earnings for the foreign currency forward contracts category are generally included in cost of sales in the Company's consolidated statements of operations. For a description of the Company's use of foreign currency forward contracts, refer to Note 9.

9. Foreign currency forward contracts

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

Table of Contents

During the thirty-nine weeks ended November 28, 2015 and November 29, 2014, the TCS segment used forward contracts for 86% and 49% of inventory purchases in Swedish krona each year, respectively. During the thirty-nine weeks ended November 28, 2015 and November 29, 2014, the Elfa segment used forward contracts to purchase U.S. dollars in the amount of \$3,580 and \$3,500, which represented 58% and 70% of the Elfa segment's U.S. dollar purchases each year, respectively. Generally, the Company's foreign currency forward contracts have terms from 1 to 12 months and require the Company to exchange currencies at agreed-upon rates at settlement.

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

The Company records all foreign currency forward contracts on its consolidated balance sheet at fair value. The Company accounts for its foreign currency hedging instruments in the TCS segment as cash flow hedges, as defined. Changes in the fair value of the foreign currency hedging instruments that are considered to be effective, as defined, are recorded in other comprehensive income (loss) until the hedged item (inventory) is sold to the customer, at which time the deferred gain or loss is recognized through cost of sales. Any portion of a change in the foreign currency hedge instrument's fair value that is considered to be ineffective, as defined, or that the Company has elected to exclude from its measurement of effectiveness, is immediately recorded in earnings as cost of sales. The Company assessed the effectiveness of the foreign currency hedge instruments and determined the foreign currency hedge instruments were highly effective during the thirty-nine weeks ended November 28, 2015 and November 29, 2014. Forward contracts not designated as hedges in the Elfa segment are adjusted to fair value as selling, general, and administrative expenses on the consolidated statements of operations. During the thirty-nine weeks ended November 28, 2015, the Company recognized a net unrealized loss of \$181 associated with the change in fair value of forward contracts not designated as hedging instruments.

The Company had \$8 in accumulated other comprehensive loss related to foreign currency hedge instruments at November 28, 2015, all of which represents a loss for settled foreign currency hedge instruments related to inventory on hand as of November 28, 2015. The Company expects the loss of \$8, net of taxes, to be reclassified into earnings over the next 12 months as the underlying inventory is sold to the end customer.

The change in fair value of the Company's foreign currency hedge instruments that qualify as cash flow hedges and are included in accumulated other comprehensive income (loss), net of taxes, are presented in Note 8 of these financial statements.

10. Fair value measurements

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

Edgar Filing: Container Store Group, Inc. - Form 10-Q

- Level 1 Valuation inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.

- Level 2 Valuation inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Edgar Filing: Container Store Group, Inc. - Form 10-Q

Table of Contents

- Level 3 Valuation inputs are unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are determined using model-based techniques that include option pricing models, discounted cash flow models and similar techniques.

As of November 28, 2015, February 28, 2015 and November 29, 2014, the Company held certain items that are required to be measured at fair value on a recurring basis. These included the nonqualified retirement plan and foreign currency forward contracts. The nonqualified retirement plan consists of investments purchased by employee contributions to retirement savings accounts. The Company's foreign currency forward contracts consist of over-the-counter (OTC) contracts, which are not traded on a public exchange. See Note 9 for further information on the Company's foreign currency forward contract activities.

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

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

Description		Balance Sheet Location	November 28, 2015	February 28, 2015	November 29, 2014
Assets					
Nonqualified retirement plan	Level 2	Other current assets	\$4,124	\$3,951	\$3,955
Foreign currency forward contracts	Level 2	Other current assets	290	486	-
Total assets			\$4,414	\$4,437	\$3,955
Liabilities					
Nonqualified retirement plan	Level 2	Accrued liabilities	4,132	3,966	3,962
Foreign currency hedge instruments	Level 2	Accrued liabilities	-	315	641
Total liabilities			\$4,132	\$4,281	\$4,603

The fair value of long-term debt was estimated using quoted prices as well as recent transactions for similar types of borrowing arrangements (level 2 valuations). As of November 28, 2015, February 28, 2015 and November 29, 2014, the estimated fair value of the Company's long-term debt, including current maturities, was \$339,474, \$327,830, and \$349,545, respectively.

11. Segment reporting

The Company's operating segments were determined on the same basis as how management evaluates performance internally. The Company's two operating segments consist of TCS and Elfa. The TCS segment includes the Company's retail stores, website and call center, as well as

installation and organizing services.

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

Edgar Filing: Container Store Group, Inc. - Form 10-Q

Table of Contents

Amounts in the Corporate/Other column include unallocated corporate expenses and assets, intersegment eliminations and other adjustments to segment results necessary for the presentation of consolidated financial results in accordance with GAAP.

In general, the Company uses the same measurements to calculate earnings or loss before income taxes for operating segments as it does for the consolidated Company. However, interest expense related to the Senior Secured Term Loan Facility and the Revolving Credit Facility is recorded in the Corporate/Other column.

Thirteen Weeks Ended November 28, 2015	TCS	Elfa	Corporate/ Other	Total
Net sales to third parties	\$177,638	\$19,603	\$-	\$197,241
Intersegment sales	-	21,147	(21,147)	-
Interest expense, net	-	76	4,137	4,213
Income (loss) before taxes	1,951	4,268	(8,644)	(2,425)
Assets(1)	650,223	104,937	34,033	789,193

Thirteen Weeks Ended November 29, 2014	TCS	Elfa	Corporate/ Other	Total
Net sales to third parties	\$168,468	\$22,454	\$-	\$190,922
Intersegment sales	-	24,776	(24,776)	-
Interest expense, net	2	130	4,133	4,265
Income (loss) before taxes(2)	9,161	10,207	(9,877)	9,491
Assets(1)	638,235	125,925	25,406	789,566

Thirty-Nine Weeks Ended November 28, 2015	TCS	Elfa	Corporate/ Other	Total
Net sales to third parties	\$509,861	\$52,695	\$-	\$562,556
Intersegment sales	-	40,155	(40,155)	-
Interest expense, net	6	269	12,336	12,611
Income (loss) before taxes	11,114	3,240	(20,524)	(6,170)
Assets(1)	650,223	104,937	34,033	789,193

Thirty-Nine Weeks Ended November 29, 2014	TCS	Elfa	Corporate/ Other	Total
Net sales to third parties	\$493,011	\$64,596	\$-	\$557,607
Intersegment sales	-	45,924	(45,924)	-
Interest expense, net	14	537	12,399	12,950
Income (loss) before taxes(2)	24,500	10,245	(22,330)	12,415
Assets(1)	638,235	125,925	25,406	789,566

(1) Assets in Corporate/Other include assets located in the corporate headquarters and distribution center. Assets in Corporate/Other also include deferred tax assets and the fair value of TCS forward contracts.

Edgar Filing: Container Store Group, Inc. - Form 10-Q

(2) The Elfa column includes a gain on disposal of subsidiary and real estate of \$3,830 for the thirteen and thirty-nine weeks ended November 29, 2014.

Table of Contents

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

Cautionary note regarding forward-looking statements

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

Edgar Filing: Container Store Group, Inc. - Form 10-Q

Table of Contents

stock; substantial future sales of our common stock, or the perception that such sales may occur, which could depress the price of our common stock; risks related to being a public company; anti-takeover provisions in our governing documents, which could delay or prevent a change in control; reduced disclosure requirements applicable to emerging growth companies, which could make our stock less attractive to investors; and our failure to establish and maintain effective internal controls. Other important risk factors that could affect the outcome of the events set forth in these statements and that could affect our operating results and financial condition are described in the Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended February 28, 2015, filed with the Securities and Exchange Commission (the SEC) on May 8, 2015.

We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. These forward-looking statements speak only as of the date of this report. Because forward-looking statements are inherently subject to risks and uncertainties, you should not rely on these forward-looking statements as predictions of future events. Except as required by applicable law, we do not plan to publicly update or revise any forward-looking statements contained herein after the date of this report, whether as a result of any new information, future events or otherwise.

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

We follow a 5-4-4 fiscal calendar, whereby each fiscal quarter consists of thirteen weeks grouped into one five-week month and two four-week months, and our fiscal year is the 52- or 53-week period ending on the Saturday closest to February 28. Fiscal 2015 ends on February 27, 2016, fiscal 2014 ended on February 28, 2015 and fiscal 2013 ended on March 1, 2014. The third quarter of fiscal 2015 ended on November 28, 2015 and the third quarter of fiscal 2014 ended on November 29, 2014, and both included thirteen weeks.

Overview

We are the original and leading specialty retailer of storage and organization products in the United States and the only national retailer solely devoted to the category. We provide creative, multifunctional, customizable storage and organization solutions that help our customers save time, save space and improve the quality of their lives. Through a differentiated shopping experience delivered by expert salespeople, our goal is to deliver the promise of an organized life to our customers. These customers are predominantly female, highly educated and busy from college students to empty nesters.

Our operations consist of two operating segments:

- *The Container Store* (TCS), which consists of our retail stores, website and call center, as well as our installation and organizational services business. As of November 28, 2015, we operated 77 stores with an average size of approximately 25,000 square feet (19,000 selling square feet) in 28 states and the District of Columbia. Our stores present our products in a unique and engaging atmosphere. Our visual merchandising team works to ensure that all of our merchandise is appropriately showcased to highlight the value and functionality of our products and maximize the appeal of our image and brand. We maintain a consistent store layout which creates a familiar shopping experience across our store base. Our stores are clean and spacious with strict, orderly merchandising and strategic product placements to optimize our selling space and increase productivity. We allow our customers to shop with us in a variety of ways anywhere, anytime, any way she wants

Edgar Filing: Container Store Group, Inc. - Form 10-Q

through an omnichannel shopping experience. Our stores receive substantially all of our products directly from our distribution center co-located with our corporate headquarters in Coppell, Texas.

- *Elfa*, The Container Store, Inc.'s wholly owned Swedish subsidiary, Elfa International AB (Elfa), which designs and manufactures component-based shelving and drawer systems and made-to-measure sliding doors. Elfa was founded in 1948 and is headquartered in Malmö, Sweden. Elfa's shelving and drawer systems are

Edgar Filing: Container Store Group, Inc. - Form 10-Q

Table of Contents

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

Note on Dollar Amounts

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

Results of Operations

The following data represents the amounts shown in our unaudited consolidated statements of operations expressed in dollars and as a percentage of net sales and operating data for the periods presented (categories that are only applicable to our TCS segment are noted with (*) and to our Elfa segment with (+)). For segment data, see Note 11 to our unaudited consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 28,	November 29,	November 28,	November 29,
	2015	2014	2015	2014
Net sales	\$197,241	\$190,922	\$562,556	\$557,607
Cost of sales (excluding depreciation and amortization)	81,137	77,063	233,299	229,230
Gross profit	116,104	113,859	329,257	328,377
Selling, general, and administrative expenses (excluding depreciation and amortization)	101,949	93,842	289,469	275,015
Stock-based compensation*	487	404	1,164	950
Pre-opening costs*	2,994	1,597	6,870	6,943
Depreciation and amortization	8,834	7,776	25,249	22,599
Other expenses	-	363	-	1,170
Loss (gain) on disposal of assets	52	(3,879)	64	(3,665)
Income from operations	1,788	13,756	6,441	25,365
Interest expense	4,213	4,265	12,611	12,950
(Loss) income before taxes	(2,425)	9,491	(6,170)	12,415
(Benefit) provision for income taxes	(694)	3,242	(1,913)	2,790
Net (loss) income	\$(1,731)	\$6,249	\$(4,257)	\$9,625

Edgar Filing: Container Store Group, Inc. - Form 10-Q

Table of Contents

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 28,	November 29,	November 28,	November 29,
	2015	2014	2015	2014
Percentage of net sales:				
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales (excluding depreciation and amortization)	41.1%	40.4%	41.5%	41.1%
Gross profit	58.9%	59.6%	58.5%	58.9%
Selling, general and administrative expenses (excluding depreciation and amortization)	51.7%	49.2%	51.5%	49.3%
Stock-based compensation*	0.2%	0.2%	0.2%	0.2%
Pre-opening costs*	1.5%	0.8%	1.2%	1.2%
Depreciation and amortization	4.5%	4.1%	4.5%	4.1%
Other expenses	0.0%	0.2%	0.0%	0.2%
Loss (gain) on disposal of assets	0.0%	(2.0%)	0.0%	(0.7%)
Income from operations	0.9%	7.2%	1.1%	4.5%
Interest expense	2.1%	2.2%	2.2%	2.3%
(Loss) income before taxes	(1.2%)	5.0%	(1.1%)	2.2%
(Benefit) provision for income taxes	(0.4%)	1.7%	(0.3%)	0.5%
Net (loss) income	(0.9%)	3.3%	(0.8%)	1.7%
Operating data:				
Comparable store sales*(1)	0.5%	(3.5%)	0.0%	(1.6%)
Number of stores open at end of period*	77	69	77	69
Non-GAAP measures(2):				
Adjusted EBITDA(3)	\$13,833	\$23,398	\$38,382	\$56,978
Adjusted net (loss) income(4)	\$(1,731)	\$3,207	\$(4,257)	\$4,744
Adjusted net (loss) income per common share - diluted(4)	\$(0.04)	\$0.07	\$(0.09)	\$0.10

(1) A store is included in the comparable store sales calculation on the first day of the sixteenth full fiscal month following the store's opening. When a store is relocated, we continue to consider sales from that store to be comparable store sales. Net sales from our website and call center are also included in calculations of comparable store sales. The comparable store sales growth operating measure in a given period is based on merchandise and service orders placed in that period, excluding shipping and delivery, which may not always reflect when the merchandise and services are received by the customer. Prior to fiscal 2015, the comparable store sales growth operating measure did not include net sales from services. The comparable store sales growth metric is an operating measure intended only as supplemental information and is not a substitute for net sales presented in accordance with generally accepted accounting principles (GAAP).

(2) We have presented certain non-GAAP measures as supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. These non-GAAP measures should not be considered as alternatives to net income (loss) as a measure of financial performance or cash flows from operations as a measure of liquidity, or any other performance measure derived in accordance with GAAP and they should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items. These non-GAAP measures are key metrics used by management and our board of directors to assess our financial performance. These non-GAAP measures are frequently used by analysts, investors and other interested parties to evaluate companies in our industry. In evaluating these non-GAAP measures, you should be aware that in the future we will incur expenses that are the same as or similar to some of the adjustments in this presentation. Our presentation of these non-GAAP measures should not be construed to imply that our future results will be unaffected by any such adjustments. Management compensates for these limitations by relying on our GAAP.

Edgar Filing: Container Store Group, Inc. - Form 10-Q

Table of Contents

results in addition to using non-GAAP measures supplementally. Our non-GAAP measures are not necessarily comparable to other similarly titled captions of other companies due to different methods of calculation.

Additionally, this Management's Discussion and Analysis also refers to Elfa third party net sales after the conversion of Elfa's net sales from Swedish krona to U.S. dollars using the prior year's conversion rate. The Company believes the disclosure of Elfa third party net sales without the effects of currency exchange rate fluctuations helps investors understand the Company's underlying performance.

(3) EBITDA and Adjusted EBITDA have been presented as supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. EBITDA and Adjusted EBITDA are not intended to be measures of free cash flow for management's discretionary use, as they do not reflect certain cash requirements such as tax payments, debt service requirements, capital expenditures, store openings and certain other cash costs that may recur in the future. EBITDA and Adjusted EBITDA contain certain other limitations, including the failure to reflect our cash expenditures, cash requirements for working capital needs and cash costs to replace assets being depreciated and amortized.

A reconciliation of the GAAP financial measure of net income (loss) to the non-GAAP financial measures of EBITDA and Adjusted EBITDA is set forth below:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 28, 2015	November 29, 2014	November 28, 2015	November 29, 2014
Net income (loss)	\$(1,731)	\$6,249	\$(4,257)	\$9,625
Depreciation and amortization	8,834	7,776	25,249	22,599
Interest expense, net	4,213	4,265	12,611	12,950
Income tax provision (benefit)	(694)	3,242	(1,913)	2,790
EBITDA	10,622	21,532	31,690	47,964
Pre-opening costs*(a)	2,994	1,597	6,870	6,943