PRICESMART INC
Form 10-K/A
January 26, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Amendment No. 1)

(Mark One)

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

For the fiscal year ended August 31, 2005

OR

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

Commission File Number: 000-22793

PRICESMART, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**33-0628530**
(State of other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

9740 SCRANTON ROAD, SAN DIEGO, CA 92117

(Address of principal executive offices, Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

COMMON STOCK, $0.0001 PAR VALUE

RIGHTS TO PURCHASE SHARES OF COMMON STOCK, PAR VALUE $0.0001

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K/A. Yes x No ¨

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

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-Accelerated Filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.). Yes ¨ No x

The aggregate market value of the Registrant s voting stock held by non-affiliates of the Registrant as of February 28, 2005 was $70,573,447, based on the last reported sale of $7.85 per share on February 28, 2005.

As of January 23, 2006, a total of 26,556,505 shares of Common Stock were outstanding.

The following items of PriceSmart, Inc. s Annual Report on Form 10-K for the fiscal year ended August 31, 2005 are hereby amended. Each such item is set forth in its entirety, as amended.

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Explanatory Note

This Amendment No. 1 to PriceSmart, Inc. s (PriceSmart or the Company) Annual Report on Form 10-K/A for the year ended August 31, 2005 amends and restates Items 7, 8 and 9A of Part II of the original Form 10-K, and no other information included in the original Form 10-K is amended hereby.

In connection with a routine review by the Securities and Exchange Commission of a post-effective amendment on Form S-3 to a registration statement filed by the Company on Form S-1, the Company has revised its consolidated statements of cash flows set forth in Item 8 of Part II to reflect the impact of cash flows used in discontinued operations on cash flows provided by (used in) operating activities, investing activities and financing activities rather than allocating all of the cash flows used by discontinued operations in a separate section of the statement. In addition, and as a result of this enhanced presentation of cash flows, the Company revised its treatment of the change in deferred tax assets attributable to the disposition of the Company s interest in PSMT Philippines from continuing operations to discontinued operations within the operating activities section of the statement of cash flows. The Company has revised Item 7 of Part II: Management s Discussion and Analysis of Results of Operations and Financial Condition to reflect this revised statement of cash flows presentation. These revisions do not change the Company s previously reported revenue, operating income, net loss, net increase (decrease) in cash and cash equivalents, assets, liabilities or stockholders equity.

The Company also revised Item 9A of Part II to clarify that the Company s Interim Chief Executive Officer and Chief Financial Officer determined that disclosure controls and procedures were not effective as to a reasonable assurance level at the end of fiscal year 2005.

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PRICESMART, INC.

ANNUAL REPORT ON FORM 10-K/A

FOR THE YEAR ENDED AUGUST 31, 2005

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

This Annual Report contains forward-looking statements concerning the Company s anticipated future revenues and earnings, adequacy of future cash flow and related matters. These forward-looking statements include, but are not limited to, statements containing the words expect, believe, will, may, should, project, estimate, scheduled, and like expressions, and the negative thereof. These statements are subject to risks and uncertainties that could cause actual results to differ materially, including the following risks: the Company had substantial losses in fiscal 2003, 2004 and 2005 and may continue to incur losses in future periods; the Company is required to comply with financial covenants governing our outstanding indebtedness; the Company s financial performance is dependent on international operations; any failure by the Company to manage its widely dispersed operations could adversely affect its business; although the Company has taken steps to significantly improve its internal controls, there may be material weaknesses or significant deficiencies that the Company has not yet identified; the Company faces significant competition; the Company may encounter difficulties in the shipment of and inherent risks in the importation of merchandise to its warehouse clubs; the Company is exposed to weather and other risks associated with international operations; declines in the economies of the countries in which the Company operates its warehouse clubs would harm its business; a few of the Company s stockholders have control over the Company s voting stock, which will make it difficult to complete some corporate transactions without their support and may prevent a change in control; the loss of key personnel could harm the Company s business; the Company is subject to volatility in foreign currency exchange; the Company faces the risk of exposure to product liability claims, a product recall and adverse publicity; a determination that the Company s long-lived or intangible assets have been impaired could adversely affect the Company s future results of operations and financial position; and the Company faces increased costs and compliance risks associated with Section 404 of the Sarbanes-Oxley Act of 2002; as well as the other risks detailed in the Company s SEC reports, including the Company s Form 10-K for the fiscal year ended August 31, 2005 filed pursuant to the Securities Exchange Act of 1934.

The following discussion and analysis compares the results of operations for each of the three fiscal years ended August 31, 2005 and should be read in conjunction with the consolidated financial statements and the accompanying notes included elsewhere in this report.

PriceSmart s mission is to efficiently operate U.S.-style membership warehouse clubs in Central America and the Caribbean that sell high quality merchandise at low prices to PriceSmart members and that provide fair wages and benefits to PriceSmart employees as well as a fair return to PriceSmart stockholders. The Company delivers quality imported U.S. brand-name and locally sourced products to its small business and consumer members in a warehouse club format that provides the high value to its members. By focusing on providing exceptional value on quality merchandise in a low cost operating environment, the Company seeks to grow sales volume and membership which in turn will allow for further efficiencies and price reductions and ultimately improved value to our members.

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PriceSmart s business consists primarily of international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. The number of warehouse clubs in operation, as of August 31, 2005 and August 31, 2004 and the Company s ownership percentages and basis of presentation for financial reporting purposes by each country or territory are as follows:

Country/Territory	Number of Warehouse Clubs in Operation (as of August 31, 2005)	Number of Warehouse Clubs in Operation (as of August 31, 2004)	Ownership (as of August 31, 2005)	Basis of Presentation
Panama	4	4	100%	Consolidated
Costa Rica	3	3	100%	Consolidated
Dominican Republic	2	2	100%	Consolidated
Guatemala	2	2	100%	Consolidated
Philippines		4	52%	Consolidated(1)
El Salvador	2	2	100%	Consolidated
Honduras	2	2	100%	Consolidated
Trinidad	2	2	90%	Consolidated
Aruba	1	1	90%	Consolidated
Barbados	1	1	100%	Consolidated
Guam			100%	Consolidated(1)
U.S. Virgin Islands	1	1	100%	Consolidated
Jamaica	1	1	67.5%	Consolidated
Nicaragua	1	1	51%	Consolidated
Totals	22	26		
Mexico		3	50%	Equity
Grand Totals	22	29		

(1) Country/territory is treated as discontinued operations in the consolidated financial statements.

During fiscal 2005, the Company sold its interest in PSMT Philippines, Inc., the Company s former Philippine subsidiary, resulting in the reduction of four consolidated warehouse clubs. The sale was completed August 12, 2005. During fiscal 2004, the Company opened a new membership shopping warehouse club in the Philippines and closed its warehouse club in Guam. At the end of fiscal 2005, the total number of consolidated warehouse clubs in operation was 22, operating in 11 countries and one U.S. territory in comparison to 26 warehouse clubs operating in 12 countries and one U.S. territory at the end of fiscal 2004, and 26 consolidated warehouse clubs operating in 12 countries and two U.S. territories at the end of fiscal 2003. The average life of the 22 warehouse clubs in operation as of August 31, 2005 was 59 months. The average life of the 26 warehouse clubs in operation as of August 31, 2004 was 47 months. The Company has opened a fourth warehouse club in Costa Rica on November 18, 2005.

During the third quarter of fiscal year 2005, the Company acquired the minority interest in its PricesSmart Guatemala subsidiary, which previously had been 66% owned by the Company.

On February 11, 2005, it was announced that the Company and Grupo Gigante S.A. de C.V. had decided to close the warehouse club operations of PSMT Mexico, S.A. de C.V. This closure was completed February 28, 2005. PSMT Mexico, S.A. de C.V. is a 50/50 joint venture of PriceSmart and Grupo Gigante S.A. de C.V. which had operated three membership warehouse clubs in Mexico. The joint venture sold two of the

three locations consisting of land and buildings in September 2005. One location remains unsold although efforts are underway to sell it as well. The fixtures and equipment are also being sold. As of the end of August 2005, PriceSmart, Inc. had acquired approximately $1.5 million of the fixtures and equipment for use in the Company s other warehouse clubs.

With the sale of the Company s interest in PSMT Philippines, Inc., all associated financial information for it as well as those of the Company s Guam operation qualify for treatment as discontinued operations in the Company s financial statements. The prior periods have been reclassified for comparative purposes.

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Key items for fiscal year 2005 included:

- Net warehouse sales increased 14.1% over the prior year, driven entirely by an increase in comparable warehouse club sales.
- Membership income for fiscal 2005 increased 18.7% to $9.4 million representing an 11% increase in membership accounts, continued strong renewal rates at 84%, and a 5% increase in the average membership fee.
- Gross profits (net warehouse sales less cost of merchandise) increased 18.4% over the prior year on the higher warehouse sales, and gross margin increased 50 basis points as a percent of net warehouse sales.
- Selling, general and administrative expenses as a percentage of net warehouse sales improved 180 basis points, as increased sales offset the expense increases associated with wages, utilities, credit cards, and costs related to public company compliance.
- Loss from operations for the fiscal year was $5.3 million, which included $11.4 million in asset impairment and closure costs.
- The closure of PSMT Mexico and impairment charges and continuing losses, $4.4 million for fiscal 2005.
- The sale of PSMT Philippines during the year, and the prior year closure of Guam resulted in the Company recognizing largely non-cash charges of $19.5 million as discontinued operations, net of tax.
- The exchange of common stock for outstanding shares of Series A and Series B Preferred Stock as part of the Company s previously disclosed Financial Program resulted in the Company taking a non-cash charge of $20.6 million associated with a deemed dividend .

Comparison of Fiscal 2005 and Fiscal 2004

Net warehouse club sales increased 14.1% to $605.0 million in fiscal 2005 from $530.3 million in fiscal 2004. The Company s sales were positively impacted by a generally strong economic environment in its markets. Warehouse clubs in all countries registered increased sales from fiscal 2004 to fiscal 2005. In particular, sales growth in the Dominican Republic, which was positively impacted by the strengthening of the Dominican peso compared to the US dollar, contributed 310 basis points of the year to year sales growth. The following table indicates the percent growth in net warehouse club sales in the segments in which the Company operates.

	Years Ended August 31,					
	2005		2004			
	Amount	% of Net Revenue	Amount	% of Net Revenue	Increase (Decrease)	Change

	(Amounts in thousands)					
Central America	$ 369,673	61.1%	$ 340,661	64.2%	$ 29,012	8.5%
Caribbean	235,321	38.9%	189,601	35.8%	45,720	24.1%
	$ 604,994	100.0%	$ 530,262	100.0%	$ 74,732	14.1%

The sales increase for the year was entirely due to sales growth on a comparable warehouse club basis as no new warehouse clubs were added during the year. Comparable warehouse club sales, which are for warehouse clubs open at least 13.5 full months, increased 14.1% for the 52-week period ended September 4, 2005, compared to the same period last year. The Company reports comparable warehouse sales on a same week basis with 13 weeks in each quarter beginning on a Monday and ending on a Sunday. The periods are established at the beginning of the fiscal year to provide as close a match as possible to the calendar month that is used for financial reporting purposes. This approach equalizes the number of weekend days and week days in each period for improved sales comparison, as the Company experiences higher warehouse club sales on the weekends.

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Further, each of the warehouse clubs used in the calculations was open for at least 13 1/2 calendar months before its results for the current period were compared with its results for the prior period. For example, if a warehouse club opened during the fourth fiscal quarter on June 14, 2004, it would not be included in the comparable warehouse club sales until the first comparison of July 2005 with July 2004. For purposes of quarterly comparisons of comparable warehouse club sales, July and August 2005 results for this hypothetical warehouse club would be compared to July and August 2004 for the fourth quarter comparable sales. June 2005 results would not be taken into account in making the comparison. By contrast, a warehouse club opened June 16, 2004 would not be included in comparable warehouse club sales until the first comparison of August 2005 with August 2004.

The following table indicates the approximate percentage of net sales accounted for by each major category of items sold by the Company during the fiscal years ended August 31, 2005, 2004 and 2003:

	Fiscal Year Ended August 31,		
	2005	2004	2003
Sundries (including candy, snack foods, health and beauty aids, tobacco, alcoholic beverages, soft drinks, cleaning and paper products and pet supplies)	29%	29%	28%
Food (including dry and fresh foods)	44%	43%	47%
Hardlines (including major appliances, electronics, hardware, office supplies, garden and patio, sporting goods, business machines and automotive supplies)	17%	17%	13%
Softlines (including apparel, domestics, cameras, jewelry, housewares, media, toys, home furnishings, and small appliances)	8%	9%	10%
Other (including one-hour photo and food court)	2%	2%	2%
	100%	100%	100%

The Company s warehouse club gross profit margin (defined as net warehouse club sales less associated cost of goods sold) for fiscal 2005 increased $13.7 million to $88.4 million, or 14.6% of net warehouse sales, from $74.6 million, or 14.1% of net warehouse sales for fiscal 2004. The improvement in gross margin as a percent of sales generally reflects improvements in the merchandise and operating efforts of the Company during the year as margins as a percentage of sales increased in substantially all merchandise categories. Margins for the full year were also positively impacted by foreign exchange movements during the year, particularly in the Dominican Republic. Compared to the prior year, fiscal 2005 margins as a percentage of sales improved 30 basis points due to foreign currency exchange. The increases in margin were partially offset by a $1.0 million charge to cost of goods sold in fiscal 2005 resulting from a customs inspection covering fiscal years 2001, 2002 and 2003 in one of the Company s foreign subsidiaries. This charge reduced fiscal 2005 margin as a percentage of sales by 17 basis points.

Membership income, which is recognized into income ratably over the one-year life of the membership, increased 18.7% to $9.4 million, or 1.6% of net warehouse sales, in fiscal 2005 compared to $7.9 million, or 1.5% of net warehouse sales, in fiscal 2004. The increase in membership income reflects both a 10.9% increase in the number of membership accounts and a 5.0% increase in the average membership fee. Total membership accounts as of the end of fiscal 2005 were approximately 414,000, an increase of approximately 41,000 accounts over the end of fiscal 2004. As no new warehouse clubs were opened in fiscal 2005, the increase in membership came from existing warehouse clubs. The membership renewal rate for fiscal 2005 was 84%.

Other income consists of commission revenue, rental income, advertising revenue, construction revenue, fees for in-store product demonstrations, and fees earned from licensees. Other income for fiscal 2005 was $4.0 million compared to $4.9 million in fiscal 2004. The decrease in other income reflects the reduction in licensing fees associated with the Company s previously announced termination of the technology and trademark licensing agreements with the Company s former China licensee. License fees in fiscal 2004 associated with the China

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licensee were $1.0 million. Other income in fiscal 2005 was positively impacted by the recognition of $400,000 of income related to marketing income in the second fiscal quarter which is not expected to be recurring.

Warehouse operating expenses increased 4.7% to $73.4 million, or 12.1% of warehouse sales, for fiscal 2005 from $69.8 million, or 13.2% of warehouse sales, in fiscal 2004. The $3.5 million increase in operating expenses were primarily a result of higher utility costs of $834,000 and increased costs of credit card fees related to higher sales of $755,000. In addition, payroll related expenses increased $1.3 million from fiscal 2004 to fiscal 2005 reflecting increased wages and the addition of staff in certain locations. Across all spending categories, the strengthening of the Dominican peso against the U.S. dollar resulted in an increase of $2.1 million related solely to the translation of local currency expenses to the U.S. dollar for financial statement reporting. Higher sales resulted in a 110 basis point improvement in warehouse operating expenses as a percent of sales in fiscal 2005 compared to the prior year.

General and administrative expenses decreased to $22.3 million, or 3.7% of net warehouse sales, for fiscal 2005 from $23.1 million, or 4.4% of net warehouse sales, in fiscal 2004. In fiscal 2005, the Company incurred approximately $1.5 million in outside consultants in the analysis and documentation of processes related to compliance with the Sarbanes-Oxley Act, and $700,000 in settlement costs related to securities litigation. The Company also recorded $500,000 in litigation costs related to the Guatemala and Philippines disputes during the year, and $603,000 related to the termination of an option to sell certain parcels of land that was initially granted in 2001 in exchange for 75,212 shares of the Company s common stock. By comparison, in fiscal 2004, the Company incurred $1.0 million in costs during the year for outside professional services attributable to legal proceedings arising from the Company s restatement of financial results for fiscal year 2002 and the first three quarters of fiscal 2003. General and administrative expenses in fiscal 2004 also included a $0.6 million bad debt expense attributable to the outstanding receivable due from the Company s China licensee for license fees billed in the second and third quarter of fiscal 2004. The Company also incurred severance costs of $0.9 million during fiscal year 2004.

Pre-opening expenses, which represent expenses incurred before a warehouse club is in operation, were $99,000 for the year associated with the Company s fourth location in Costa Rica, which opened on November 18, 2005.

Asset impairment and closure costs for fiscal year 2005 were $11.4 million compared to $1.2 million in fiscal year 2004. Included in the current year was a $7.1 million non-cash asset impairment charge taken in the third fiscal quarter associated with the write-down of the long-lived assets (leasehold improvements, and furniture and equipment) at the Company s U.S. Virgin Islands warehouse club operation. The Company also incurred asset impairment and closure costs during the year primarily related to a reassessment of certain liabilities and long-lived assets for its previously closed warehouse locations in Guatemala ($1.6 million) and Dominican Republic ($2.4 million). The Guatemala location, which is leased by the Company, has been sublet effective July, 2005. The Dominican Republic location is owned and is being marketed for sale. The charge taken in the fourth fiscal quarter for the Dominican Republic location reflects management s revised assessment of the likely net selling price for the property. In fiscal 2004, the Company incurred $1.2 million in costs and non-cash charges which included $0.5 million for the closed Guatemala location, $166,000 in connection with the closure of a west coast U.S. distribution center in the fourth quarter, and ongoing carrying costs during the period.

Interest income reflects earnings on cash, cash equivalent balances and restricted cash deposits securing either long term debt or working capital lines of credit. Interest income was $1.8 million in fiscal 2005 and $1.9 million in fiscal 2004.

Interest expense primarily reflects borrowings by the Company s majority or wholly owned foreign subsidiaries to finance the capital requirements of the initial construction of the warehouse clubs, local currency loans secured by U.S. deposits and on-going capital requirements. Interest expense for fiscal year 2005 was $5.4 million, compared to $7.9 million in fiscal year 2004. The decrease in interest expense reflects a reduction in

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debt during the current fiscal year. The Company paid off or converted to equity $77.1 million in short and long term debt during the year as a result of the cash received in January 2005 associated with the issuance of 6.8 million shares of common stock and the conversion of certain debt to common stock as described in the Company s Financial Program, see Note 11 Financial Program.

During fiscal 2005, the Company incurred foreign current tax expense of $4.7 million, which included $2.6 million for income tax contingencies. The Company also recognized a net deferred tax expense of $4.4 million, primarily related to the use of NOL on the U.S. income from continuing operations, resulting in a net tax expense of $9.1 million. During fiscal 2004, the Company incurred current income tax expense of $3.1 million (primarily related to its foreign operations, including provisions for income tax contingencies). The Company also recognized a net deferred tax expense of $1.1 million in 2004, primarily related to the increase of valuation allowances for foreign deferred tax assets, resulting in a net tax expense of $4.2 million.

Minority interest relates to the allocation of the joint venture income or loss to the minority interest stockholders respective interests. Minority interest stockholders respective share of net losses was $566,000 in fiscal 2005 compared to $697,000 in fiscal 2004. In fiscal 2005 the Company began recording 100% of the loss of the Company s Aruba subsidiary resulting from that subsidiary having offset the minority interest stockholder s equity through accumulated losses.

Equity of unconsolidated affiliate represents the Company s 50% share of losses from its Mexico joint venture. The joint venture is accounted for under the equity method of accounting in which the Company reflects its proportionate share of income or loss. On February 11, 2005 it was announced that the Company and Grupo Gigante S.A. had decided to close the warehouse club operations of PSMT Mexico, S.A. de C.V. This closure was completed February 28, 2005. The joint venture sold two of the three locations consisting of land and buildings in September 2005 for an aggregate price of $11.2 million. One location remains unsold although efforts are underway to sell it as well. The fixtures and equipment are also being sold. The proceeds from the sale of assets after all liabilities are satisfied will be distributed to the joint venture shareholders. Consequently, the Company continues to evaluate the carrying value of its investment with respect to the expected realizable value from those actions. Since the beginning of the fiscal year, the Company has recognized a $4.4 million reduction in the carrying value of its equity investment. Of that amount, $791,000 is associated with the Company s 50% share of the operating losses through January 2005, the last full month before the closure announcement. The remaining $3.6 million relates to operating losses subsequent to January 2005, as well as, charges taken to reduce the value of the Company s equity investment to the expected realizable value. In fiscal year 2004, the Company s 50% share of losses of the joint venture was $4.8 million.

Discontinued operations, net of taxes relates to the consolidated income and expenses associated with those operations within the Company that were closed or disposed of and which meet the criteria for such a treatment. These operations include PSMT Philippines which was disposed of effective August 12, 2005, and the costs associated with the Company s previously closed warehouse location in Guam.

The costs included in discontinued operations, net of taxes are comprised of the following:

	Fiscal 2005	Fiscal 2004	Fiscal 2003
Guam pre-tax loss from operations	$ (74)	$ (3,117)	$ (7,825)
Philippines pre-tax loss from operations	(4,232)	(8,950)	(3,341)
Pre-tax loss on divestiture	(24,827)		
Loss before income taxes and minority interest	(29,133)	(12,067)	(11,166)
Income tax (provision) benefit	9,674	(8)	

Minority interest		2,881	2,163
Discontinued operations, net of tax	$ (19,459)	$ (9,194)	$ (9,003)

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Preferred dividends of $648,000 reflect the accrued but unpaid dividends on the Company s preferred stock for that portion of fiscal year 2005 prior to the exchange of common stock for the outstanding preferred stock in the first quarter. In fiscal 2004, the accrued but unpaid dividends for the preferred stock was $3.4 million. The Company had issued 20,000 shares of Series A Preferred Stock on January 22, 2002, which accrued 8% annual dividends that were cumulative and payable in cash. The Company issued 22,000 shares of Series B Preferred Stock on July 9, 2003, which accrued 8% annual dividends that were cumulative and payable in cash, and were subordinate to the Series A Preferred Stock.

The Company recorded a $20.6 million non-cash charge in the first quarter of fiscal 2005 to reflect the deemed dividend resulting from the exchange of common stock for outstanding shares of Series A and Series B preferred stock in that quarter. The basis for this charge is discussed in Note 11 Financial Program of the financial statements.

Comparison of Fiscal 2004 and Fiscal 2003

Net warehouse club sales increased 0.8% to $530.3 million in fiscal 2004 from $526.0 million. The Company experienced a reduction in wholesale business activity and lower than anticipated holiday sales due to inadequate merchandise levels in fiscal 2004 compared to fiscal 2003. The two warehouse clubs that were closed prior to the beginning of fiscal 2004 accounted for $26.3 million in net warehouse sales in fiscal 2003. The two new warehouse clubs which opened during fiscal 2003 accounted for an incremental $36.6 million in net warehouse sales in fiscal 2004 as compared to fiscal 2003. The following table indicates the percentage change in net warehouse club sales in the segments in which the Company operates.

	Years Ended August 31,					
	2004		2003			
	Amount	% of Net Revenue	Amount	% of Net Revenue	Increase (Decrease)	Change
	(Amounts in thousands)					
Central America	$ 340,661	64.2%	$ 351,587	66.8%	$ (10,926)	(3.1)%
Caribbean	189,601	35.8%	174,383	33.2%	15,218	8.7%
	$ 530,262	100.0%	$ 525,970	100.0%	$ 4,292	0.82%

The Company s warehouse club gross profits (defined as net warehouse club sales less associated cost of goods sold) for fiscal 2004 increased $4.6 million to $74.6 million, or 14.1% of net warehouse sales, from $70.0 million, or 13.3% of net warehouse sales, for fiscal 2003. The improvement in gross margin generally reflects improvements in the merchandise and operating efforts of the Company during the year. Gross margins for the full year were positively impacted by reduced inventory shrink and lower markdowns as compared to the prior year, partially offset by costs incurred related to currency devaluations in certain markets during the year, most notably in Nicaragua.

Export sales represent U.S. merchandise exported to the Company s licensee warehouse clubs operating in Saipan, direct sales to third parties from the Company s distribution centers and sales to PriceSmart Mexico, an unconsolidated affiliate (see Note 14 Related Party Transactions in

the Notes to Consolidated Financial Statements included within), which began in fiscal 2003. Export sales were $1.1 million in fiscal 2004 compared to $7.0 million in fiscal 2003. The decrease of $5.9 million was primarily due to decreased direct sales to third parties through the Company s distribution centers which include sales to PriceSmart Mexico, an unconsolidated affiliate. Export sales were $7.0 million in fiscal 2003 compared to $2.4 million in fiscal 2002. The increase was primarily due to increased sales to PriceSmart Mexico during the period when its warehouse clubs were initially opened.

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Membership income, which is recognized into income ratably over the one-year life of the membership, increased 13.5% to $7.9 million, or 1.5% of net warehouse sales, in fiscal 2004 compared to $7.0 million, or 1.3% of net warehouse sales, in fiscal 2003. The increase in membership income reflects an increase in the average membership fee that the Company is charging in most locations.

Other income consists of commission revenue, rentals, advertising, merchandise demonstration income, construction revenue and fees earned from licensees. Non-license fee income decreased $1.0 million in fiscal 2004 from fiscal 2003 to $3.8 million. The decrease is attributable to the discontinuation of certain promotional programs and a reduction in merchandise demonstration activity in fiscal 2004 as compared to fiscal 2003. License fees for fiscal 2004 were $1.1 million compared to $1.2 million in the prior year resulting primarily from the Company s decision to not record income associated with its China licensee in the fourth quarter pending resolution of certain matters, including the payment of past due amounts. In October 2004, the Company concluded that, in view of the lack of substantive progress arising from the parties discussions regarding past-due payments to be made by the licensee to the Company under the PRC Technology License Agreement (Amended) entered into in February 2001; it should proceed with sending a notice of default relating to the licensee s non-payment. Accordingly, on October 7, 2004, the Company issued a notice of default to the licensee, demanding the payment of all due amounts within 30 days. The Company subsequently terminated the licensing agreement.

Warehouse operating expenses increased to $69.8 million, or 13.2% of warehouse sales, for fiscal 2004 from $66.2 million, or 12.6% of warehouse sales, in fiscal 2003. The increase in operating expense is attributable to an increase in utilities, repairs and maintenance, increased wage rates in certain warehouse club locations and increased costs with respect to credit card usage and fees.

General and administrative expenses increased to $23.1 million, or 4.4% of net warehouse sales, for fiscal 2004 from $22.3 million, or 4.2% of net warehouse sales, in fiscal 2003. The Company incurred $1.0 million in costs during the year for outside professional services attributable to legal proceedings arising from the Company s restatement of financial results for fiscal year 2002 and the first three quarters of fiscal 2003. General and administrative expenses in fiscal 2004 also include a $0.6 million bad debt expense attributable to the outstanding receivable due from the Company s China licensee for license fees billed in the second and third quarter of fiscal 2004. The Company incurred severance costs of $0.9 million during fiscal year 2004 (compared to $1.1 million in severance costs in fiscal 2003) and experienced increased insurance costs associated with workers compensation and director and officer liability as compared to fiscal 2003.

Expenses incurred before a warehouse club is in operation are captured in pre-opening expenses. During fiscal 2004, the Company incurred no pre-opening expenses. In fiscal 2003, two new warehouse clubs were opened for a total cost of $2.0 million.

Asset impairment and closure costs reflect the costs associated with the closure of warehouse clubs (including related severance payments), carrying costs of long-lived assets at previously closed warehouse club locations, and non-cash charges to properly reflect the book value of certain long lived assets or lease obligations based upon management s assessment of fair market value for those assets or liabilities. In fiscal 2004, the Company incurred $1.2 million in costs and non-cash charges, primarily related to either the cost of closing a warehouse club, an updated assessment as to the fair market value and future cash flows of previously closed warehouse locations, or the ongoing carrying costs of assets at those locations. The estimated cash flows based upon market conditions for the previously closed Guatemala location resulted in a non-cash charge in the fourth fiscal quarter of $0.5 million. The Company had previously recorded a $3.8 million charge in fiscal 2003 relating to closure of the Guatemala warehouse club at the time of the club s closing. Carrying costs for closed locations were $0.5 million for the fiscal year. The Company also recognized $166,000 in costs in connection with the closure of a west coast U.S. distribution center in the fourth quarter.

During fiscal 2003, the Company closed two warehouse clubs, one each in the Dominican Republic and Guatemala. The warehouse clubs were closed June 15, 2003 and August 15, 2003, respectively. The decision to

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close these warehouse clubs resulted from the determination that the locations were not conducive to the successful operation of a PriceSmart warehouse club. The Company recorded closure costs and asset impairment charges of $7.1 million related to those warehouse clubs closed as of August 31, 2003.

Interest income primarily reflects earnings on cash, cash equivalent balances and restricted cash. Interest income was $1.9 million in fiscal 2004 and $2.5 million in fiscal 2003.

Interest expense primarily reflects borrowings by the Company s majority or wholly owned foreign subsidiaries to finance the capital requirements of new and existing warehouse clubs, and was $7.9 million for fiscal 2004 compared with $9.1 million in fiscal 2003

Income from related party of $500,000 in fiscal 2004 relates to an incentive the Company received from its then landlord, Price Legacy Corporation, to terminate early the lease of its corporate headquarters. The Company moved to its new corporate headquarters in San Diego on March 26, 2004. Sol Price, a significant stockholder of the Company, was at the time also a principal stockholder of Price Legacy Corporation, and directors Murray L. Galinson and Jack McGrory served on both companies boards of directors.

During fiscal 2004, the Company incurred current income tax expense of $3.1 million (primarily related to its foreign operations, including provisions for income tax contingencies). The Company also recognized a net deferred tax expense of $1.1 million in 2004, primarily related to the increase of valuation allowances for foreign deferred tax assets, resulting in a net tax expense of $4.2 million. During fiscal 2003, the Company incurred a net tax expense of $225,000, which included $858,000 for current foreign tax expense and a net deferred tax benefit of $640,000, primarily related to the reversal of a valuation allowance previously established against U.S. net deferred tax assets, offset by increases in the valuation allowances for foreign deferred tax assets.

Equity of unconsolidated affiliate represents the Company s 50% share of losses from its Mexico joint venture. The joint venture is accounted for under the equity method of accounting, in which the Company reflects its proportionate share of income or loss. Losses from the Mexico joint venture in fiscal 2004 were $3.4 million of which the Company s share was $1.7 million. During the fourth quarter of fiscal 2004, due to the historical operating losses and management s assessment as to the inability to recover the full carrying amount of its investment in PSMT Mexico, S.A. de C.V., the Company recorded a charge of $3.1 million to reduce the Company s investment in unconsolidated affiliate. In fiscal 2003, the first year of operation, the Mexico joint venture had net losses of $5.9 million, of which the Company s share was $3.0 million.

Minority interest relates to the allocation of the joint venture income or (loss) to the minority interest stockholders respective interests. Minority interest stockholders respective share of net losses was $0.7 million in fiscal 2004 compared to $3.1 million in fiscal 2003.

Preferred dividends of $3.4 million and $1.9 million reflect dividends paid or accrued on the Company s preferred stock for fiscal years 2004 and 2003, respectively. In fiscal 2002, the Company issued 20,000 shares of Series A Preferred Stock on January 22, 2002, which accrued 8% annual dividends that were cumulative and payable in cash. In fiscal 2003, the Company issued 22,000 shares of Series B Preferred Stock on July 9, 2003, which accrued 8% annual dividends that were cumulative and payable in cash, and are subordinate to the Series A Preferred Stock. On September 5, 2003, the Company determined it would not declare a dividend on the preferred stock, but the preferred dividends continued to accrue. At end of fiscal 2004, the Company had approximately $3.9 million in accrued preferred dividends in other current liabilities.

Liquidity and Capital Resources

Financial Position and Cash Flow

The Company s primary capital requirements are for the operating working capital needs of the Company, particularly those associated with the acquisition of an adequate level of U.S. and locally sourced merchandise

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for the Company s warehouse clubs. In addition, funds during the last fiscal year were required as a result of the Company s acquisition and subsequent construction of its new warehouse club in Costa Rica which opened in November 2005.

The Company ended fiscal year 2005 with $30.1 million in unrestricted cash and an additional $7.3 million in cash that is used to secure a working capital facility, the outstanding balance of which as of August 31, 2005 was zero and $5.2 million of commercial and standby letters of credit as of August 31, 2005.

The Company ended fiscal year 2005 with surplus working capital (defined as current assets less current liabilities) of $25.2 million compared to a working capital deficit of $1.3 million as of August 31, 2004. During the year, the Company s working capital position improved by $26.5 million, attributable to the reduction of $18.9 million in current indebtedness and the conversion of approximately $20 million in short-term related party borrowings to common stock as part of the Financial Program (see Note 11 Financial Program in the Notes to Consolidated Financial Statements included herein).

Net operating cash flows provided by continuing activities were $11.1 million for fiscal year 2005 compared to $19.6 million in fiscal year 2004, a change of $8.5 million. In fiscal year 2005, the Company increased merchandise inventories by $9.4 million from the beginning of the year due to higher inventory levels planned for the 2005 holiday season. In fiscal year 2004, the Company decreased merchandise inventories by $7.6 million from the beginning of that year. This change of $17.0 million was offset by that portion of the fiscal year 2005 loss from continuing operations attributable to non-cash impairment charges of $11.4 million compared to $1.2 million in fiscal year 2004. Net operating cash used in discontinued activities was $5.5 million in the current fiscal year compared to a net cash use of $6.7 million in fiscal 2004. The activities associated with discontinued operations primarily relate to the operating activities and the subsequent disposal of the Company s Philippine subsidiary. Total net cash provided by operating activities was $5.7 million in fiscal 2005 compared to $12.9 million in fiscal 2004.

Net cash (used in) provided by investing activities for continuing operations was $(10.8) million and $3.6 million in fiscal years 2005 and 2004, respectively. The increase in the use of cash resulted primarily from the acquisition of land and the initial building costs associated with the new warehouse club location in Costa Rica. Through August 31, 2005, approximately $7.0 million has been invested in the new location, which is expected to cost approximately $10.2 million. In fiscal year 2004, the Company received an advance payment of $5.0 million for the sale of property in the Dominican Republic. The sale did not occur and the $5.0 million advance payment was subsequently converted to common shares.

Financing activities for continuing operations provided $14.1 million in fiscal year 2005 compared to $15.1million in fiscal 2004. A number of transactions related to the Financial Program (see Note 11 Financial Program in the Notes to Consolidated Financial Statements included herein) occurred during fiscal year 2005. The Company received $47.8 million from the sale of 6,827,542 shares of the Company s common stock pursuant to the exercise of subscription rights during the $7 exercise period of the Company s previously announced rights offering. The $7 subscription period ended on January 24, 2005. The $8 subscription period extends until January 31, 2006. For the period from January 31, 2005 to August 31, 2005, the Company has received $624,000 for the sale of 78,061 shares under the $8 rights offering. In fiscal year 2005, the Company reduced total debt by $77.1 million; $26.4 million was through conversion to common stock and $50.7 million was through net principal repayments and the complete retirement of the debt, including $12.2 million associated with debt held by the Philippines and recorded as a use of cash in discontinued activities.

Financing Activities

The Company concluded significant phases of its previously announced Financial Program during the fiscal year (See Note 11 Financial Program in the Notes to Consolidated Financial Statements included herein).

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In the first fiscal quarter of 2005, the Company exchanged shares of its common stock, valued for such purposes at $10 per share, for $22 million of its Series B Cumulative Convertible Redeemable Preferred Stock. The Company also exchanged shares of its common stock valued for such purposes at $8 per share for a $25 million bridge loan plus accrued interest, the $5 million real estate advance for the subsequently cancelled sale of the Dominican Republic land and building plus accrued interest and $14.9 million of purchase order financing plus accrued interest, each extended to the Company by The Price Group, LLC. The Price Group, LLC is affiliated with Robert E. Price, Interim Chief Executive Officer, Chairman of the Board of Directors and a significant stockholder of the Company and Sol Price, a significant stockholder of the Company and father of Robert E. Price. Directors Robert E. Price, Murray L. Galinson, Jack McGrory and former director James F. Cahill were at the time co-managers of The Price Group, LLC and collectively owned a significant interest in that entity. In addition, as part of a separate transaction, the Company converted $20 million of its Series A Cumulative Convertible Redeemable Preferred Stock plus accrued dividends to common stock valued for such purpose at $10 per share.

In addition, the Company purchased a $10.2 million long-term note of its then Philippine subsidiary from the International Finance Corporation (IFC) and paid-off the outstanding balance of a $3.8 million long-term note to the Overseas Private Investment Corporation (OPIC). The Company simultaneously obtained the release of $6.8 million in restricted cash being held as partial collateral for those loans as part of the Financial Program.

On November 5, 2004, the Company entered into a short-term loan agreement for $3.0 million for a period of 90 days at a rate of 5% with The Price Group, LLC. This short-term loan was repaid on January 10, 2005.

In the second quarter of fiscal 2005, the Company received $47.8 million as a result of the sale of 6,827,542 shares of the Company s common stock pursuant to the exercise of subscription rights during the $7 exercise period of the Company s previously announced rights offering. The $7 subscription period ended on January 24, 2005. The $8 subscription period extends until January 31, 2006; thus far 78,061 shares of common stock have been sold during the $8 subscription period. The rights offering is part of the Financial Program.

In the third quarter of fiscal 2005, the Company repaid approximately $29.3 million in long-term debt with proceeds from the $7 subscription rights.

During fiscal year 2005, the Company retired or converted to equity $77.1 million of short and long-term debt.

Short-Term Borrowings and Long-Term Debt

As of August 31, 2005, the Company, together with its majority or wholly-owned subsidiaries, had $1.6 million outstanding in short-term borrowings. At the end of fiscal 2004, the Company, together with its majority or wholly-owned subsidiaries, had $12.7 million in short-term borrowings.

Additionally, the Company has a bank credit agreement for up to $7.0 million, which can be used as a line of credit or to issue letters of credit. As of August 31, 2005, letters of credit totaling $5.2 million were outstanding under this facility, leaving availability under this facility of $1.8 million.

As of August 31, 2005, the Company, together with its majority or wholly-owned subsidiaries, had $29.3 million outstanding in long-term borrowings. The Company s long-term debt is collateralized by certain land, building, fixtures, equipment and shares of each subsidiary to which the debt relates and guaranteed by the Company up to its respective ownership percentage, except for approximately $3.8 million as of August 31, 2005, which is secured by stand-by letters of credit. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.

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The Company has debt agreements, with an aggregate principal amount outstanding as of August 31, 2005 of $22.9 million that, among other things, allow the lender to accelerate the indebtedness upon a default by the Company under other indebtedness and prohibit the Company from incurring additional indebtedness unless the Company is in compliance with specified financial ratios. As of August 31, 2005, the Company satisfied these ratios.

As part of the Philippines divestiture agreement, the Company remains a guarantor on three loans that PSMT Philippines obtained prior to the divestiture. The Company has guaranteed 52% of approximately $5.9 million in outstanding loans, or $3.1 million. The guarantees on two of the loans, with outstanding balances of $2.9 million as of August 31, 2005, remain in effect for the life of the loans but the third loan, with an outstanding balance as of August 31, 2005 of $3.0 million, will lapse when the outstanding principal balance falls below $2.0 million. These loans also have leasehold improvements and furniture, fixtures and equipment pledged as collateral. The fair value was determined using an estimate of the cost to insure a loan with these attributes based on calculations derived from a government agency that provides insurance coverage for international export credit risk.

Contractual Obligations

As of August 31, 2005, the Company s commitments to make future payments under long-term contractual obligations were as follows (in thousands):

	Payments Due by Period				
Contractual Obligations[1]	**Total**	**Less than 1 Year**	**1 to 3 Years**	**4 to 5 Years**	**After 5 Years**
Long-term debt[2]	$ 29,332	$ 5,417	$ 14,273	$ 8,830	$ 812
Operating leases	123,998	6,975	13,174	13,357	90,492
Total	$ 153,330	$ 12,392	$ 27,447	$ 22,187	$ 91,304

(1) Amounts exclude Philippine loan guarantees.
(2) Amounts shown are for the principal portion of the long-term debt payment only. Future interest obligations will vary with changes in future LIBOR rates, making an accurate projection of future interest payments difficult.

Critical Accounting Estimates

The preparation of the Company s financial statements requires that management make estimates and judgments that affect the financial position and results of operations. Management continues to review its accounting policies and evaluate its estimates, including those related to contingencies and litigation, deferred taxes, merchandise inventories, goodwill, long-lived assets and warehouse closure costs. The Company bases its estimates on historical experience and on other assumptions that management believes to be reasonable under the present circumstances. These accounting policies, under different conditions or using different estimates, could show materially different results on the Company s financial condition and results of operations.

Contingencies and Litigation: In the ordinary course of business, the Company is periodically named as a defendant in various lawsuits, claims and pending actions. The principal risks that the Company insures against are workers compensation, general liability, vehicle liability, property damage, employment practices, errors and omissions, fiduciary liability and fidelity losses. If a potential loss arising from these lawsuits, claims and actions is probable and reasonably estimable, the Company records the estimated liability based on circumstances and assumptions existing at the time. While the Company believes the recorded liabilities are adequate, there are inherent limitations in the estimation process whereby future actual losses may exceed projected losses, which could materially adversely affect the Company s results of operations or financial condition.

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Deferred Taxes: A valuation allowance is recorded to reduce deferred tax assets to the amount that is more likely than not to be realized. As of August 31, 2005, the Company evaluated its deferred tax assets and liabilities and determined that, in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, a valuation allowance is necessary for certain foreign deferred tax asset balances, primarily because of the existence of significant negative objective evidence, such as the fact that certain countries are in a cumulative loss position for the past three years, and the determination that certain net operating loss carry-forward periods are not sufficient to realize the related deferred tax assets. The Company factored into its analysis the inherent risk of forecasting revenue and expenses over an extended period of time and also considered the potential risks associated with its business. As a result of this review, the Company concluded that a full valuation allowance was required with respect to deferred tax assets in all but three of its subsidiaries as well as certain U.S. deferred tax assets.

The Company has federal and state tax net operating loss carry-forwards, or NOLs, at August 31, 2005 of approximately $63.6 million and $15.8 million, respectively. In calculating the tax provision, and assessing the likelihood that the Company will be able to utilize the deferred tax assets, the Company considered and weighed all of the evidence, both positive and negative, and both objective and subjective. The Company factored in the inherent risk of forecasting revenue and expenses over an extended period of time and considered the potential risks associated with its business. Because of the Company s U.S. income from continuing operations and based on projections of future taxable income in the U.S., which have increased due to the implementation of the Financial Program (as described in Note 11 to the Consolidated Financial Statements for the year ended August 31, 2005 included herein), the Company was able to determine that there was sufficient positive evidence to support the conclusion that it was more likely than not that the Company would be able to realize substantially all of it U.S. NOLs by generating taxable income during the carry-forward period. However, if the Company does not achieve its projections of future taxable income in the U.S., the Company could be required to take a charge to earnings related to the recoverability of these deferred tax assets. Also, as a result of the Financial Program, the Company believes that due to the deemed change of ownership (as defined in section 382 of the Internal Revenue Code), there will be annual limitations in the amount of U.S. profits that may be offset by NOLs. While the exact amount of this limitation has not yet been determined, based on preliminary calculations, the Company does not believe this will impact the recoverability of these NOLs. However, due to the significant net increase in NOLs for 2005, primarily as a result of the disposal of its Philippines operations, the Company did place a valuation allowance on $8.7 million of its NOLs. Due to their shorter recovery period and limitations applicable under section 383 of the Internal Revenue code regarding changes of ownership, the Company has maintained valuation allowances on U.S. foreign tax credits (generated before the date of the deemed ownership change) and capital loss carry-forwards.

Merchandise Inventory: The Company records its inventory at the lower of cost (average cost) or market. The Company provides for estimated inventory losses between physical inventory counts on the basis of a percentage of sales. The provision is adjusted periodically (monthly) 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 monitors slow-moving inventory to determine if provisions should be taken for expected markdowns below the carrying cost of certain inventory to expedite the sale of such merchandise.

Goodwill: Statement of Financial Accounting Standards No. 142, Accounting for Goodwill and Other Intangibles, requires that the Company test goodwill for impairment based on a comparison of fair values to the carrying values of its reporting units (subsidiaries). The determination of fair value for a reporting unit involves the use of assumptions and estimates such as the future performance of the operations of the reporting unit and discount rates used to determine the current value of expected future cash flows of the reporting unit. Any change in these assumptions and estimates, and other factors such as inflation rates, competition and general economic conditions, could cause the calculated fair value of the operating unit to decrease significantly.

Long-lived Assets: 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 market value consistent with SFAS 144. Future business conditions and/or activity could differ materially from the projections made by management causing the need for additional impairment charges. The Company recorded a $7.1 million impairment charge in the third quarter of fiscal 2005 to write-down the long-lived assets of the U.S. Virgin Islands warehouse club. The Company also recorded a $2.4 million impairment charge in the fourth quarter of fiscal 2005 to write-down the long-lived assets at the closed Dominican Republic warehouse.

Warehouse Closure Costs: The Company provides estimates for warehouse club closing costs when it is appropriate to do so, based on the applicable accounting principles. The Company has established lease obligation liabilities for its closed leased warehouse clubs. The lease obligations are based on the present value of the rent liabilities reduced by the estimated income from the subleasing of these properties. The Company is continually evaluating the adequacy of its closed warehouse club lease obligations based upon the status of existing or potential subleasing activity and makes appropriate adjustments to the lease obligations as a result of these evaluations. Future circumstances may result in the Company s actual future closing costs or the amount recognized upon sale or sublease of the property to differ materially from the original estimates.

Basis of Presentation: The consolidated financial statements include the assets, liabilities and results of operations of the Company s majority and wholly owned subsidiaries that are more than 50% owned and controlled. All significant intercompany balances and transactions have been eliminated in consolidation. The Company s 50% owned Mexico joint venture is accounted for under the equity method of accounting.

Accounting Pronouncements

In May 2005 the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS 154 requires retrospective application to prior periods financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle, such as a change in non-discretionary profit-sharing payments resulting from an accounting change, should be recognized in the period of the accounting change. SFAS 154 also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted for accounting changes and corrections of errors made in fiscal years beginning after the date this Statement is issued. The Company is required to adopt the provisions of SFAS 154, as applicable, beginning in fiscal 2007. The Company does not believe that the adoption of SFAS 154 will have a significant effect on its future consolidated financial statements.

In March 2005, the FASB issued FASB Interpretation (FIN) No. 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143, which requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability s fair value can be reasonably estimated. The Company is required to adopt the provisions of FIN 47 no later than the end of its fiscal 2006. The Company does not believe that the adoption of FIN 47 will have a significant effect on its future consolidated financial statements.

During December 2004, the FASB issued Statement No. 123R, Share-Based Payment (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. Stock-based payments include stock option grants. The Company grants options to purchase common stock to some of its employees and directors under various plans at prices equal to the market value of the stock on the dates the options were granted. SFAS 123R is effective for all interim or annual periods beginning after

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June 15, 2005. Early adoption is encouraged and retroactive application of the provisions of SFAS 123R to the beginning of the fiscal year that includes the effective date is permitted, but not required. The Company adopted this pronouncement September 1, 2005 and is currently evaluating the expected impact that the adoption of SFAS 123R will have on its future consolidated financial statements.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs An Amendment of ARB No. 43, Chapter 4 (SFAS 151). SFAS 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs and spoilage should be expensed as incurred and not included in overhead. Further, SFAS 151 requires that allocation of fixed and production facilities overheads to conversion costs should be based on normal capacity of the production facilities. The provisions in this statement are effective for inventory costs incurred during fiscal periods beginning after June 15, 2005. The Company does not believe that the adoption of SFAS 151 will have a significant effect on its future consolidated financial statements.

In November 2004, the FASB issued SFAS No. 153, Exchanges of Non-monetary Assets An Amendment of APB No. 29 (SFAS 153). The provisions of this statement are effective for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. This statement eliminates the exception to fair value for exchanges of similar productive assets and replaces it with a general exception for exchange transactions that do not have commercial substance that is, transactions that are not expected to result in significant changes in the cash flows of the reporting entity. The Company does not believe that the adoption of SFAS 153 will have a significant effect on its future consolidated financial statements.

Seasonality

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

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Item 8. Financial Statements

REPORT OF ERNST & YOUNG LLP, INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

PriceSmart, Inc.

We have audited the accompanying consolidated balance sheets of PriceSmart, Inc. as of August 31, 2005 and 2004, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended August 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 15(b). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of PriceSmart, Inc. at August 31, 2005 and 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended August 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

San Diego, California

November 18, 2005

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PRICESMART, INC.

CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except share data)

	August 31,	
	2005	**2004**
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 30,147	$ 32,910
Short-term restricted cash	7,331	7,255
Receivables, net of allowance for doubtful accounts of $2,260 and $1,011 in 2005 and 2004, respectively	1,906	1,542
Receivables from unconsolidated affiliate	811	
Merchandise inventories	65,719	56,357
Prepaid expenses and other current assets	8,410	9,272
Assets of discontinued operations	118	49,442
Total current assets	114,442	156,778
Long-term restricted cash	1,045	18,222
Property and equipment, net	142,310	147,488
Goodwill	29,600	23,071
Deferred tax asset	22,260	16,009
Other assets	4,108	3,870
Long-term receivables from unconsolidated affiliate		1,316
Investment in unconsolidated affiliate	6,089	9,254
Total Assets	$ 319,854	$ 376,008
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Short-term borrowings	$ 1,648	$ 12,699
Accounts payable	57,423	50,470
Accounts payable to and advances received from related party		20,273
Accrued salaries and benefits	4,513	4,149
Deferred membership income	4,773	3,758
Income taxes payable	2,271	746
Other accrued expenses	12,704	14,291
Long-term debt, current portion	5,417	13,219
Liabilities of discontinued operations	506	38,431
Total current liabilities	89,255	158,036
Long-term deferred tax liability	958	592
Deferred rent	1,427	468
Accrued closure costs	3,466	3,378
Long-term debt, related party		25,000
Long-term debt, net of current portion	23,915	57,172
Total liabilities	119,021	244,646
Minority interest	2,560	3,483
Commitments and contingencies		
Stockholders Equity:		
Preferred stock, $.0001 par value (stated at cost), 2,000,000 shares authorized;		

Series A convertible preferred stock 20,000 shares designated, None and 20,000 shares issued and outstanding, respectively (liquidation preference of $0 and $21,867, respectively)		19,914
Series B convertible preferred stock 30,000 shares designated, None and 22,000 shares issued and outstanding, respectively (liquidation preference of $0 and $24,014, respectively)		21,975
Common stock, $.0001 par value, 45,000,000 shares authorized; 26,031,180 and 7,775,655 shares issued and 25,596,755 and 7,339,810 shares outstanding (net of treasury shares), respectively	3	1
Additional paid-in capital	340,659	170,255
Tax benefit from exercise of stock options	3,379	3,379
Notes receivable from stockholders	(29)	(33)
Deferred compensation	(1,015)	(1,932)
Accumulated other comprehensive loss	(13,757)	(18,314)
Accumulated deficit	(121,534)	(57,902)
Less: treasury stock at cost; 434,425 and 435,845 shares, respectively	(9,433)	(9,464)
Total stockholders equity	198,273	127,879
Total Liabilities and Stockholders Equity	$ 319,854	$ 376,008

See accompanying notes.

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PRICESMART, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(amounts in thousands, except per share data)

	Years Ended August 31,		
	2005	**2004**	**2003**
Revenues:			
Sales:			
Net warehouse club	$ 604,994	$ 530,262	$ 525,970
Export	425	1,052	7,039
Membership income	9,424	7,939	6,995
Other income	3,982	4,938	5,991
Total revenues	618,825	544,191	545,995
Operating expenses:			
Cost of goods sold:			
Net warehouse club	516,611	455,626	455,945
Export	394	1,090	6,749
Selling, general and administrative:			
Warehouse club operations	73,361	69,846	66,188
General and administrative	22,310	23,098	22,283
Preopening expenses	99		1,966
Asset impairment and closure costs	11,361	1,236	7,087
Total expenses	624,136	550,896	560,218
Operating loss	(5,311)	(6,705)	(14,223)
Other income (expense):			
Interest income	1,754	1,929	2,512
Interest expense	(5,385)	(7,930)	(9,126)
Other expense	(994)	(215)	(308)
Income from related party		500	
Total other income (expense)	(4,625)	(5,716)	(6,922)
Loss from continuing operations before provision for income taxes, losses (including impairment charges in 2005 and 2004) of unconsolidated affiliate and minority interest	(9,936)	(12,421)	(21,145)
Provision for income taxes	(9,140)	(4,236)	(225)
Losses (including impairment charges of $1.1 million and $3.1 million in 2005 and 2004, respectively) of unconsolidated affiliate	(4,368)	(4,828)	(2,967)
Minority interest	566	697	3,114
Loss from continuing operations	(22,878)	(20,788)	(21,223)
Discontinued operations, net of tax	(19,459)	(9,194)	(9,003)

Net loss	(42,337)	(29,982)	(30,226)
Preferred dividends	(648)	(3,360)	(1,854)
Deemed dividend on exchange of common stock for preferred stock	(20,647)		
Net loss attributable to common stockholders	$ (63,632)	$ (33,342)	$ (32,080)
Basic and diluted loss per share common stockholders:			
Continuing operations	$ (1.13)	$ (2.85)	$ (3.09)
Discontinued operations, net of tax	$ (0.96)	$ (1.26)	$ (1.31)
Preferred and deemed dividends	$ (1.06)	$ (0.46)	$ (0.27)
Attributable to common stockholders	$ (3.15)	$ (4.57)	$ (4.67)
Shares used in per share computation, basic and diluted	20,187	7,290	6,865

See accompanying notes.

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PRICESMART, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

FOR THE THREE YEARS ENDED AUGUST 31, 2005

(amounts in thousands)

	Preferred Stock Series A & Series B		Common Stock		Additional paid-in capital	Tax benefit from exercise of stock options	Notes receivable from stockholders	Deferred compensation	Accumulated other comprehensive inc/ (loss)	Retained earnings (accumulated deficit)	Less: Treasury Stock		Total stockholders equity
	Shares	Amount	Shares	Amount							Shares	Amount	
alance at ugust 31, 002	20	19,914	7,283	1	161,094	3,360	(769)	(95)	(6,292)	7,520	498	(11,322)	173,411
suance of eries B onvertible referred stock	22	21,983											21,983
ividends on referred stock										(1,854)			(1,854
suance of easury stock					632						(79)	1,801	2,433
xercise of ock options			3		6						(5)	124	130
ax benefit om exercise f stock ptions						19							19
tock ompensation xpense					2,388			(1,555)					833
mortization f deferred ompensation								336					336
ayment on otes eceivable om ockholders													84
et loss										(30,226)			(30,226
ranslation djustment									(7,730)				(7,730
omprehensive oss													(37,956
alance at ugust 31, 003	42	41,897	7,286	1	164,120	3,379	(685)	(1,314)	(14,022)	(24,560)	414	(9,397)	159,419
										(3,360)			(3,360

ividends on referred stock										
ssuance of ommon stock		500	5,000							5,000
ssuance costs f Series B onvertible referred stock	(8)									(8
epayment of otes eceivable and eacquisition of ommon stock			(101)	317				22	(67)	149
ancellation of otes eceivable om ockholders		(10)	(94)	208						114
tock ompensation xpense			1,330		(1,330)					
mortization f deferred ompensation					712					712
ayment of otes eceivable om ockholders				10						10
Mark to market f employee estricted stock				117						117
et loss							(29,982)			(29,982
ranslation djustment						(4,292)				(4,292
omprehensive oss										