PRICESMART INC
Form 10-Q
January 09, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 30, 2006

OR

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

For the transition period from ______ to ______

COMMISSION FILE NUMBER 0-22793

PriceSmart, Inc.

(Exact name of registrant as specified in its charter)

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

9740 Scranton Road, San Diego, CA 92121

(Address of principal executive offices)

(858) 404-8800

(Registrant s telephone number, including area code)

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

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 registrant had 28,983,397 shares of its common stock, par value $.0001 per share, outstanding at January 5, 2007.

Table of Contents

PRICESMART, INC.

INDEX TO FORM 10-Q

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PriceSmart, Inc. s (PriceSmart or the Company) unaudited consolidated balance sheet as of November 30, 2006, the consolidated balance sheet as of August 31, 2006, the unaudited consolidated statements of income for the three months ended November 30, 2006 and 2005, the unaudited consolidated statements of cash flows for the three months ended November 30, 2006 and 2005, are included elsewhere herein. Also included herein are notes to the unaudited consolidated financial statements.

Table of Contents

PRICESMART, INC.

CONSOLIDATED BALANCE SHEETS

(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

	November 30, 2006 (Unaudited)	August 31, 2006
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 15,261	$ 39,995
Short-term restricted cash	7,748	7,651
Receivables, net of allowance for doubtful accounts of $195 and $191, respectively	4,888	3,599
Merchandise inventories	93,730	77,432
Prepaid expenses and other current assets	9,741	8,985
Assets of discontinued operations	1,513	1,594
Total current assets	132,881	139,256
Long-term restricted cash	585	531
Property and equipment, net	165,489	162,029
Goodwill	31,801	31,870
Deferred tax asset	20,073	20,183
Other assets	1,512	1,903
Investment in unconsolidated affiliate	3,133	3,271
Total Assets	$ 355,474	$ 359,043
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Short-term borrowings	$ 677	$ 158
Accounts payable	75,861	65,520
Accounts payable to unconsolidated affiliate		381
Accrued salaries and benefits	5,658	5,765
Deferred membership income	6,249	5,780
Income taxes payable	3,600	4,098
Other accrued expenses	13,816	15,194
Long-term debt, current portion	1,000	5,417
Liabilities of discontinued operations	143	130
Total current liabilities	107,004	102,443
Deferred tax liability	961	1,101
Deferred rent	1,571	1,730
Accrued closure costs	3,189	3,226
Long-term debt, net of current portion	555	13,252
Total liabilities	113,280	121,752
Minority interest	2,808	2,672
Commitments and contingencies		
Stockholders Equity:		
Common stock, $.0001 par value, 45,000,000 shares authorized; 29,421,560 and 29,404,457 shares issued and 28,983,397 and 28,966,294 shares outstanding (net of treasury shares), respectively	3	3

Additional paid-in capital	364,774	364,132
Tax benefit from exercise of stock options	3,593	3,509
Accumulated other comprehensive loss	(13,914)	(13,883)
Accumulated deficit	(105,604)	(109,676)
Less: treasury stock at cost; 438,163 shares	(9,466)	(9,466)
Total stockholders equity	239,386	234,619
Total Liabilities and Stockholders Equity	$ 355,474	$ 359,043

See accompanying notes.

4

Table of Contents

PRICESMART, INC.

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

	Three Months Ended November 30, 2006	2005
Revenues:		
Sales:		
Net warehouse club	$ 198,100	$ 166,513
Export	95	
Membership income	3,241	2,645
Other income	1,061	816
Total revenues	202,497	169,974
Operating expenses:		
Cost of goods sold:		
Net warehouse club	168,498	142,520
Export	92	
Selling, general and administrative:		
Warehouse club operations	20,293	18,254
General and administrative	5,968	5,726
Preopening expenses	232	335
Closure costs	191	53
Total operating expenses	195,274	166,888
Operating income	7,223	3,086
Other income (expense):		
Interest income	364	312
Interest expense	(355)	(721)
Other income, net	14	24
Total other income (expense)	23	(385)
Income from continuing operations before provision for income taxes, income (loss) of unconsolidated affiliate and minority interest	7,246	2,701
Provision for income taxes	(2,973)	(1,342)
Income (loss) of unconsolidated affiliate	(85)	36
Minority interest	(134)	(44)
Income from continuing operations	4,054	1,351
Discontinued operations, net of tax	18	654
Net income	$ 4,072	$ 2,005
Basic income per share:		
Continuing operations	$ 0.14	$ 0.05
Discontinued operations, net of tax	$	$ 0.03

Net income	$	0.14	$	0.08
Diluted income per share:				
Continuing operations	$	0.14	$	0.05
Discontinued operations, net of tax	$		$	0.03
Net income	$	0.14	$	0.08
Shares used in per share computations:				
Basic		28,429		25,698
Diluted		29,105		26,005

See accompanying notes.

5

Table of Contents

PRICESMART, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED AMOUNTS IN THOUSANDS)

	Three Months Ended November 30, 2006	Three Months Ended November 30, 2005
OPERATING ACTIVITIES:		
Income from continuing operations	$ 4,054	$ 1,351
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	2,302	2,274
Allowance for doubtful accounts	4	(8)
Closure costs	191	(53)
Gain on sale of property and equipment	(18)	
Deferred income taxes	(30)	639
Minority interest	134	44
(Income) loss of unconsolidated affiliate	85	(36)
Stock-based compensation	508	437
Change in operating assets and liabilities:		
Change in accounts receivable, prepaids, other current assets, accrued salaries, deferred membership and other accruals	(3,559)	(1,083)
Merchandise inventory	(16,298)	(15,438)
Accounts payable	9,960	12,403
Net cash provided by (used in) continuing activities	(2,667)	530
Net cash provided by (used in) discontinued activities	73	(262)
Net cash provided by (used in) operating activities	(2,594)	268
INVESTING ACTIVITIES:		
Additions to property and equipment	(5,792)	(16,505)
Sale of property and equipment	22	
Purchase of Jamaica minority interest		(1,726)
Net cash used in continuing activities	(5,770)	(18,231)
Net cash provided by (used in) discontinued activities	39	(168)
Net cash used in investing activities	(5,731)	(18,399)
FINANCING ACTIVITIES:		
Proceeds from bank borrowings	667	76
Repayment of bank borrowings	(17,262)	(2,500)
Restricted cash	(151)	185
Proceeds from related party borrowing		12,500
Issuance of common stock		1,500
Proceeds from exercise of stock options	134	21
Tax benefit from exercise of stock options	84	3
Net cash provided by (used in) financing activities	(16,528)	11,785

Effect of exchange rate changes on cash and cash equivalents	119	543
Net decrease in cash and cash equivalents	(24,734)	(5,803)
Cash and cash equivalents at beginning of period	39,995	30,147
Cash and cash equivalents at end of period	$ 15,261	$ 24,344
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest, net of amounts capitalized	$ 502	$ 1,767
Income taxes	$ 3,328	$ 664
Supplemental disclosure of non-cash financing activities related to the Financial Program:		
Issuance of common stock for:		
Warrant exercise	$	$ 1,400

See accompanying notes.

Table of Contents

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

November 30, 2006

NOTE 1 COMPANY OVERVIEW AND BASIS OF PRESENTATION

PriceSmart, Inc. s (PriceSmart or the Company) business consists primarily of international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. As of November 30, 2006, the Company had 23 consolidated warehouse clubs in operation in 11 countries and one U.S. territory (four each in Panama and Costa Rica, two each in Dominican Republic, El Salvador, Guatemala, Honduras and Trinidad and one each in Aruba, Barbados, Jamaica, Nicaragua and the United States Virgin Islands), of which the Company owns at least a majority interest. During fiscal 2005, the Company sold its interest in its former Philippine subsidiary. Also, the three warehouse clubs formerly operated in Mexico as part of a 50/50 joint venture with Grupo Gigante, S.A. de C.V. were closed during the second quarter of fiscal 2005 and two of those warehouse clubs were sold in the first quarter of fiscal 2006. There was one warehouse club in operation in Saipan, Micronesia licensed to and operated by local business people as of November 30, 2006. The Company principally operates in three segments based on geographic area.

Basis of Presentation - The consolidated financial statements have been prepared on a going concern basis. The Company has an accumulated deficit of $105.6 million as of November 30, 2006. However, for the three months ended November 30, 2006, the Company had net income of $4.1 million. The Company s ability to fund its operations and service debt during fiscal 2007 has improved following the implementation and completion of the Financial Program as described in Note 8 Financial Program and improvements in the underlying business operations. As a result, the Company prepaid $14.9 million of its long-term debt during the current quarter. In addition, the Company was able to fund the build up of its inventory, which contributed to the increase of sales year over year. Certain reclassifications have been made to prior periods to conform to the current period presentation.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation - The consolidated interim financial statements of the Company included herein include the assets, liabilities and results of operations of the Company s majority and wholly owned subsidiaries as listed below. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated interim financial statements have been prepared by the Company without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC), and reflect all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary to fairly present the financial position, results of operations, and cash flows for the interim period presented. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such SEC rules and regulations. Management believes that the disclosures made are adequate to make the information presented not misleading. The results for interim periods are not necessarily indicative of the results for the full year. The interim financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company s Form 10-K for the fiscal year ended August 31, 2006.

Table of Contents

The table below indicates the Company s percentage ownership of and basis of presentation for each subsidiary as of November 30, 2006:

	Ownership	Basis of Presentation
PriceSmart Aruba	90.0%	Consolidated
PriceSmart Barbados	100.0%	Consolidated
PSMT Caribe, Inc.:		
Costa Rica	100.0%	Consolidated
Dominican Republic	100.0%	Consolidated
El Salvador	100.0%	Consolidated
Honduras	100.0%	Consolidated
PriceSmart Guam	100.0%	Consolidated(1)
PriceSmart Guatemala	100.0%	Consolidated
PriceSmart Jamaica	100.0%	Consolidated
PriceSmart Mexico	50.0%	Equity
PriceSmart Nicaragua	51.0%	Consolidated
PriceSmart Panama	100.0%	Consolidated
PriceSmart Trinidad	95.0%	Consolidated
PriceSmart U.S. Virgin Islands	100.0%	Consolidated

(1) Entity is treated as discontinued operations in the consolidated financial statements.

Use of Estimates - The preparation of financial statements in conformity with United States generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents - Cash and cash equivalents represent cash and short-term investments with maturities of three months or less when purchased.

Restricted Cash - Short-term restricted cash primarily represents time deposits that are pledged as collateral for the Company s revolving line of credit and long-term restricted cash represents deposits with Federal Regulatory agencies in Costa Rica and Panama.

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

Allowance for Doubtful Accounts - The Company generally does not extend credit to its members, but may do so for specific wholesale, government or other large volume members. The Company maintains an allowance for doubtful accounts based on assessments as to the probability of collection of specific customer accounts, the aging of accounts receivable, and general economic conditions. If the credit worthiness of a specific customer deteriorates, the Company s estimates could change and it could have a material impact on the Company s reported results.

Property and Equipment - Property and equipment are stated at cost. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets. The useful life of fixtures and equipment ranges from three to 15 years and that of buildings from ten to 25 years. Leasehold improvements are amortized over the shorter of the life of the improvement or the expected term of the lease. In some locations, leasehold improvements are amortized over a period longer than the initial lease term as management believes it is reasonably assured that the renewal option in the underlying lease will be exercised.

Lease Accounting - Certain of our operating leases provide for minimum annual payments that increase over the life of the lease. The aggregate minimum annual payments are expensed on the straight-line basis beginning when we take possession of the property and extending over the term of the related lease. The amount by which straight-line rent exceeds actual lease payment requirements in the early years of the leases is accrued as deferred rent and reduced in later years when the actual cash payment requirements exceed the straight-line expense.

8

Table of Contents

Goodwill - Goodwill resulting from certain business combinations totaled $31.8 million at November 30, 2006 and $31.9 million at August 31, 2006. The decrease in goodwill was due to the foreign exchange translation losses in Guatemala and Jamaica for $31,000 and $38,000, respectively. The Company reviews previously reported goodwill at the entity reporting level for impairment on an annual basis or more frequently if circumstances dictate. No impairment of goodwill has been recorded to date.

Revenue Recognition - The Company recognizes sales revenue when title passes to the customer. Membership income represents annual membership fees paid by the Company s warehouse club members, which are recognized ratably over the 12-month term of the membership. The historical membership fee refunds have been minimal and, accordingly, no reserve has been established for membership refunds for the periods presented. The Company recognizes and presents revenue-producing transactions on a net basis, as defined within EITF Issue No. 06-03 (EITF 06-03), How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation).

Cost of Goods Sold - The Company includes the cost of merchandise, food service and bakery raw materials, and one hour photo supplies in cost of goods sold. The Company also includes the external and internal distribution and handling costs for supplying such merchandise, raw materials and supplies to the warehouse clubs. External costs include inbound freight, duties, drayage, fees and insurance. Internal costs include payroll and related costs, utilities, consumable supplies, repair and maintenance, rent expense, and building and equipment depreciation at our distribution facilities.

Vendor consideration consists primarily of volume rebates and prompt payment discounts. Volume rebates are generally linked to pre-established purchase levels and are recorded as a reduction of cost of goods sold when the achievement of these levels is confirmed by the vendor in writing or upon receipt of funds. On a quarterly basis, the Company calculates the amount of rebates recorded in cost of goods sold that relates to inventory on hand and this amount is recorded as a reduction to inventory, if significant. Prompt payment discounts are taken in substantially all cases and, therefore, are applied directly to reduce the acquisition cost of the related inventory, with the resulting impact to cost of goods sold when the inventory is sold.

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

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

Closure Costs - The Company records the costs of closing warehouse clubs as follows: severance costs are accrued when a termination and benefit plan is communicated to the employees; lease obligations are accrued at the cease use date by calculating the net present value of the minimum lease payments net of the fair market value of rental income that could be received for these properties from third parties; all other costs are expensed as incurred. The Company closed one warehouse club during fiscal year 2004 and two warehouse clubs during fiscal year 2003. During the first quarter of fiscal year 2007, the Company s original San Pedro Sula location was vacated and the operation was relocated to a new site, which was acquired in fiscal year 2007 in another section of the city. During the first quarter of fiscal year 2007, the Company recorded an impartment charge of $72,000 related to this relocation.

Impact of Foreign Currency Rate Changes - The functional currency in many of our international subsidiaries is the local currency, which in many cases is not U.S. dollars. Assets and liabilities of these foreign subsidiaries are translated to US dollars at the exchange rate on the balance sheet date and revenue, costs and expenses are translated at average rates of exchange in effect during the period. The corresponding translation gains and losses are recorded as a component of accumulated other comprehensive loss.

Monetary assets and liabilities in currencies other than the functional currency of the respective entity are revalued to the functional currency using the exchange rate on the balance sheet date. These foreign exchange transaction gains (losses), including repatriation of funds, which are included as a part of the costs of goods sold in the consolidated statements of income, for the first fiscal quarter of 2007, and 2006 were approximately $(160,000), and $(675,000), respectively.

Table of Contents

Stock-Based Compensation - As of November 30, 2006, the Company had four stock-based employee compensation plans. In the first quarter of fiscal 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payments, which revises SFAS 123, Accounting for Stock-Based Compensation. The Company had adopted the fair value based method of recording stock options consistent with SFAS 123 for all employee stock options granted subsequent to fiscal year 2002. Specifically, the Company adopted SFAS 123 using the prospective method with guidance provided from SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure. All employee stock option grants made or re-priced since the beginning of fiscal 2003 have been or will be expensed over the related stock option vesting period based on the fair value at the date the options are granted. Prior to fiscal 2003, the Company applied Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for stock options. During the current quarter, the Company cancelled 3,600 of the 565,900 restricted stock awards granted in fiscal year 2006.

Under SFAS 123R, the Company is required to select a valuation technique or option-pricing model that meets the criteria as stated in the standard, which includes a binomial model and the Black-Scholes model. At the present time, the Company is continuing to use the Black-Scholes model. The adoption of SFAS 123R, applying the modified prospective method , as elected by the Company, requires the Company to value stock options granted prior to its adoption of SFAS 123 under the fair value method and expense these amounts over the stock options remaining vesting period. SFAS 123R also requires the Company to estimate forfeitures in calculating the expense relating to stock-based compensation as opposed to only recognizing these forfeitures and the corresponding reduction in expense as they occur. In addition, SFAS 123R requires the Company to reflect the tax savings resulting from tax deductions in excess of expense reflected as a financing cash flow in its statement of cash flows, rather than as an operating cash flow as in prior periods.

In the first quarter of fiscal 2007 and 2006, the Company recognized stock compensation expenses of $508,000 and $437,000, respectively. The stock compensation cost for the first quarter of fiscal 2007 includes $212,000 for restricted stock grants and $296,000 for stock options. The stock compensation expense for the first quarter of fiscal 2006 includes stock options only as there were no restricted stock grants at that time. The remaining unrecognized compensation expense related to unvested awards at November 30, 2006, was approximately $4.1 million and the weighted-average period of time over which this cost will be recognized is 3.8 years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants issued in the first quarter of fiscal 2007 and 2006:

	Three Months Ended November 30,	
	2006	**2005**
Risk free interest rate	4.35%	(a)
Expected life	5 years	(a)
Expected volatility	43.96%	(a)
Expected dividend yield	0%	(a)

(a) No options were granted during the first quarter of fiscal 2006.

Table of Contents

The following table summarizes stock options outstanding as of November 30, 2006, as well as activity during the first quarter then ended:

	Shares	Weighted-Average Exercise Price
Outstanding at August 31, 2006	696,787	$ 13.67
Options granted	3,000	16.67
Exercised	(20,703)	6.58
Forfeited or expired	(964)	18.18
Outstanding at November 30, 2006 (a)	678,120	$ 13.89
Exercisable at November 30, 2006	437,885	$ 16.06

(a) At November 30, 2006 the weighted-average remaining contractual life of options outstanding was 2.3 years.

At November 30, 2006, the aggregate intrinsic value of shares outstanding and shares exercisable was $2.3 million and $525,000, respectively. (The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the option).

The weighted-average grant date fair value of stock options granted during the first quarter of fiscal 2007 was $7.81 and there were no options granted during the first quarter of fiscal 2006.

Cash proceeds, tax benefits and intrinsic value related to total stock options exercised during the first quarter of fiscal 2007 and 2006 are provided in the following table (in thousands):

	Three Months Ended November 30, 2006	Three Months Ended November 30, 2005
Proceeds from stock options exercised	$ 361	$ 29
Tax benefit related to stock options exercised	$ 84	$ 3
Intrinsic value of stock options exercised	$ 225	$ 7

Accounting Pronouncements - In September 2006 the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. SFAS 157 establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement simplifies and codifies related guidance within GAAP. The Company is required to adopt SFAS 157 no later than the Company s fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact, if any, the interpretation will have on its financial statements.

In September 2006 the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 108, Section N, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB No. 108, Section N provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatement for the purpose of a materiality assessment. The Company adopted SAB No. 108, Section N in the first quarter of fiscal 2007. Adoption of SAB No. 108, Section N did not have a material impact on the Company s consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes , provides guidance associated with the recognition and measurement of tax positions and related reporting and disclosure requirements. The Company is required to adopt the provisions of FIN 48 beginning in fiscal 2008. The Company is currently evaluating the impact, if any, the interpretation will have on its financial statements.

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

Table of Contents

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 affected 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 adopted the provisions of SFAS 154, as applicable, beginning in fiscal 2007. The adoption of SFAS 154 did not have a material impact on the company s consolidated statements, as no accounting changes and error corrections were applied during the first quarter of fiscal 2007.

NOTE 3 DISCONTINUED OPERATIONS

The Company was unsuccessful in its efforts to achieve sustained profitability in its PriceSmart Philippines operation. As a result, and in part to resolve outstanding litigation between the Company and E-Class Corporation (E-Class), one of the minority shareholders of PSMT Philippines, Inc. (PSMT Philippines), the Company entered into an agreement dated August 5, 2005 to dispose of its interest (the Divestiture) in PSMT Philippines. The Divestiture was consummated on August 12, 2005.

The Company has released PSMT Philippines from its obligations with respect to amounts owed to the Company by PSMT Philippines primarily related to past merchandise shipments and has agreed to indemnify PSMT Philippines and its officers, directors, stockholders and agents and to hold them harmless from any claims arising out of previously settled litigation between the Company and its prior Philippines licensee.

In accordance with the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long- Lived Assets , the accompanying consolidated financial statements reflect the results of operations and financial position of the Philippines and Guam as discontinued operations. Following its closure in December 2003, the Company had previously included the results of operations from Guam in the closure costs line of the Statement of Operations. However, due to the shared management structure, as the Philippines and Guam activities were viewed as one activity, following the disposal of the Philippines operations, the results of the Philippines and Guam activities were consolidated in the discontinued operations line of the Statement of Operations.

The assets and liabilities of the discontinued operations are presented in the consolidated balance sheets under the captions Assets of discontinued operations and Liabilities of discontinued operations. The underlying assets and liabilities of the discontinued operations for the periods presented are as follows (in thousands):

	November 30, 2006	August 31, 2006
Cash and cash equivalents	$ 187	$ 110
Accounts receivable, net	310	429
Prepaid expenses and other current assets	5	
Other assets	1,011	1,055
Assets of discontinued operations	$ 1,513	$ 1,594
Accrued expenses	$ 143	$ 130
Liabilities of discontinued operations	$ 143	$ 130

Table of Contents

The following table sets forth key components of income from the discontinued operations of the closed warehouse clubs in Guam and the Philippines, (in thousands):

	Three Months Ended November 30, 2006	Three Months Ended November 30, 2005
Net warehouse club sales	$	$
Pre-tax income from discontinued operations	18	1,054
Income tax provision		(400)
Income from discontinued operations	$ 18	$ 654

The pre-tax income from discontinued operations, for the three months ended November 30, 2005 includes approximately $1.0 million from the reversal of the provision against recoverability of a loan principal installment and accrued interest receivable from the former Philippines subsidiary which were collected in December 2005, and the net results of the subleasing activity in Guam.

NOTE 4 COMPREHENSIVE INCOME

Comprehensive income is defined as the change in equity from transactions and other events and circumstances from non-owner sources. Comprehensive income is comprised of net income and other comprehensive income (loss), which includes certain changes in stockholders equity such as foreign currency translation of the financial statements of the Company s subsidiaries.

	Three Months Ended November 30, 2006	Three Months Ended November 30, 2005
Net income	$ 4,072	$ 2,005
Foreign currency translation adjustment	(31)	(154)
Comprehensive income	$ 4,041	$ 1,851

NOTE 5 PROPERTY AND EQUIPMENT

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

	November 30, 2006	August 31, 2006
Land	$ 48,932	$ 48,820
Building and improvements	111,567	105,123
Fixtures and equipment	63,105	61,304
Construction in progress	3,347	6,207
	226,951	221,454
Less: accumulated depreciation	(61,462)	(59,425)
Property and equipment, net	$ 165,489	$ 162,029

Building and improvements includes net capitalized interest of $1.2 million for both November 30, 2006 and August 31, 2006, respectively.

Table of Contents

NOTE 6 INCOME PER SHARE

Basic income per share is computed based on the weighted average common shares outstanding in the period. Diluted income per share is computed based on the weighted average common shares outstanding in the period and the effect of dilutive securities (options, warrants and rights) except where the inclusion is antidilutive (in thousands, except per share data):

	Three Months Ended November 30, 2006	Three Months Ended November 30, 2005
Income	$ 4,072	$ 2,005
Determination of shares:		
Average common shares outstanding	28,429	25,698
Assumed conversion of:		
Stock options	138	107
Warrants [1]		200
Restricted stock grant [2]	538	
Diluted average common shares outstanding	29,105	26,005
Net income:		
Basic income per share	$ 0.14	$ 0.08
Diluted income per share	$ 0.14	$ 0.08

(1) A warrant for 400,000 shares of common stock at an exercise price of $7 per share was issued in January 2005, at which time 200,000 shares were immediately exercised. The remaining 200,000 shares were exercised November 30, 2005.

(2) Restricted stock was issued to certain employees in the second and third quarters of fiscal 2006, the dilutive effects of which was 537,693 shares as of November 30, 2006.

NOTE 7 CLOSURE COSTS

During fiscal 2003, the Company closed two warehouse clubs, one each in the Dominican Republic and Guatemala and the Company also closed its Commerce, California distribution center on August 31, 2004. The decision to close the warehouse clubs resulted from the determination that the locations were not conducive to the successful operation of a PriceSmart warehouse club.

During the first quarter of fiscal year 2007, the Company recorded an asset impairment charge of approximately $72,000, which was due to the San Pedro Sula, Honduras location being vacated and the operation being relocated to a new site which was acquired during fiscal year 2006 in another section of the city.

A reconciliation of the changes and related liabilities derived from the closed warehouse clubs as of November 30, 2006 is as follows (in thousands):

	Liability as of August 31, 2006	Charged to Expense	Non-cash Amounts	Cash paid	Liability as of November 30, 2006
Lease obligations	$ 3,466			(63)	$ 3,403
Asset Impairment		72	(72)		
Other associated costs	36	119	(1)	(119)	35
Total	$ 3,502	191	(73)	(182)	$ 3,438

14

Table of Contents

NOTE 8 - FINANCIAL PROGRAM

On September 3, 2004, the Company announced a plan to implement a series of transactions (the Financial Program). The Financial Program was approved by the stockholders on October 29, 2004. The elements of the Financial Program and the status of each element are as follows:

A private placement of an aggregate of 3,164,726 shares of the Company s common stock, at a price of $8 per share, to The Price Group, LLC, a California limited liability company (the Price Group), to be funded through the conversion of a $25.0 million bridge loan, together with accrued and unpaid interest, extended to the Company by the Price Group in August 2004. The private placement was completed on October 29, 2004, resulting in the issuance of 3,164,726 shares of the Company s common stock.

The issuance of an aggregate of 2,200,000 shares of common stock to the Sol and Helen Price Trust, the Price Family Charitable Fund, the Robert and Allison Price Charitable Remainder Trust, the Robert and Allison Price Trust 1/10/75 (collectively, the Price Trusts) and the Price Group (collectively, with the Price Trusts, the Series B Holders) in exchange for all of the outstanding shares of the Company s 8% Series B Cumulative Convertible Redeemable Preferred Stock. This exchange was completed on October 29, 2004, resulting in the issuance of 2,200,000 shares of the Company s common stock.

The issuance of an aggregate of 2,597,200 shares of common stock, valued for such purpose at a price of $8 per share, to the Price Group in exchange for up to $20.0 million of current obligations, plus accrued and unpaid interest, owed by the Company to the Price Group. This exchange was completed on October 29, 2004, resulting in the issuance of 2,597,200 shares of the Company s common stock.

The issuance of up to 16,052,668 shares of common stock in connection with a rights offering pursuant to rights distributed to the holders of outstanding shares of common stock, and the issuance of up to 3,125,000 shares of common stock, at a price of $8 per share, to the Price Group to ensure that the above-mentioned rights offering generates at least $25.0 million in proceeds. The $7 rights offering subscription period began on December 21, 2004 and ended on January 24, 2005. A total of 6,827,542 shares of common stock were sold during this period. The total proceeds were $47.8 million. The $8 rights offering period began on January 25, 2005 and initially expired on December 21, 2005 but was extended to January 31, 2006. A total of 2,463,614 shares of common stock were sold during the $8 rights offering period. The total proceeds for the $8 rights offering period were $19.7 million.

The issuance of up to 2,223,104 shares of common stock to exchange common stock, valued for such purpose at a price of $10 per share, to the holders of all of the shares of the Company s 8% Series A Cumulative Convertible Redeemable Preferred Stock, in exchange for all of the outstanding shares of the Series A Preferred Stock at its initial stated value of $20.0 million plus all accrued and unpaid dividends. This was completed on November 23, 2004, resulting in the issuance of 2,223,104 shares of common stock.

An amendment to the Amended and Restated Certificate of Incorporation of the Company to increase the number of authorized shares of common stock from 20,000,000 to 45,000,000 shares, which was approved by the Company s stockholders on October 29, 2004.

In connection with the Financial Program described above, the Company and certain of it subsidiaries entered into an agreement with the International Finance Corporation (the IFC) in the first fiscal quarter of 2005 providing for the following: (i) the Company granted the IFC a warrant to purchase 400,000 shares of the Company s common stock at a price of $7 per share; (ii) the Company purchased a $10.2 million loan extended by the IFC to PriceSmart Philippines, Inc.; (iii) the Company obtained a waiver of certain IFC loan covenants regarding incurring additional debt, in order to borrow the $25.0 million in the bridge loan mentioned above; (iv) $5.2 million of restricted cash pledged as collateral to certain loans was released; (v) all pre-payment penalties were waived for all outstanding loans from the IFC; (vi) the net carrying costs were reduced on one loan by eliminating the IFC s right to a percentage of the Company s earnings, before interest, taxes, depreciation and amortization. Additionally, in connection with the Company s transactions with the IFC, the Price Group (a related party to the Company) granted a put option giving the right to the IFC to sell 300,000 shares of Common Stock to the Price Group at a price of $12 per share between November 30, 2005 and November 30, 2006. The put option was exercised in the second quarter of fiscal 2006 and the transaction completed in March 2006. All of the above elements were completed during the Company s first and second quarters of fiscal 2005. The warrant was issued in the second quarter of fiscal 2005, and the warrant was exercised with respect to 200,000 shares of the Company s common stock on January 26, 2005. Pursuant to the terms of the warrant, the exercise price was paid by reducing the principal amount of two of the loans extended to the Company by the IFC. As a result, long-term debt was reduced by $1.4 million. The balance of the warrant was exercised on November 30, 2005, and long-term debt was reduced by an additional $1.4 million.

Table of Contents

NOTE 9 COMMITMENTS AND CONTINGENCIES

From time to time, the Company and its subsidiaries are subject to legal proceedings, claims and litigation arising in the ordinary course of business, the outcome of which, in the opinion of management, would not have a material adverse effect on the Company. The Company evaluates such matters on a case by case basis, and vigorously contests any such legal proceedings or claims which the Company believes are without merit.

During fiscal year 2005, the Company sub-leased its closed location in Guatemala for $300,000 a year for the first and second year; $414,000 for the third year; with CPI increase not exceeding 3.5% each year for the fourth and fifth year; $500,000 for the sixth year; and with CPI increase each year not exceeding 3.5% each year for the remaining six years until the end of the sub-lease in 2017. For the discontinued operation in Guam, the Company sub-leased the warehouse for approximately the same amount as its rental expense, $400,000 a year, until the termination of the master lease in August 2011 at which time the sublease also ends. The Company s annual future minimum lease commitments for the closed warehouse clubs in Guatemala and Guam are $642,000 and $400,000, respectively.

The SEC issued a formal order of private investigation on January 8, 2004 to investigate the circumstances surrounding a financial restatement associated with fiscal year 2002 and the first three quarters of fiscal year 2003. The SEC issued subpoenas to the Company for the production of documents and has taken testimony, pursuant to subpoena, from several of the Company s present and former employees, but to the Company s knowledge there has been no activity relating to this matter for almost two years.

The Company operates in multiple international jurisdictions, which creates certain risks regarding the interpretation and enforcement of tax laws and regulations. In the ordinary course of a global business there are many transactions for which the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of inter-company arrangements to share revenue and costs. In such arrangements there are uncertainties about the amount and manner of such sharing which could ultimately result in changes once the arrangements are reviewed by taxing authorities. Although the Company believes that its approach to determining the amounts of such arrangements is reasonable, no assurance can be given that the final exposure from these matters will not be materially different than that which is reflected in the historical income tax provisions and accruals.

In evaluating the exposure associated with various tax filing positions, the Company accrues charges for probable and estimable exposures. At November 30, 2006, the Company believes it has appropriately accrued for probable exposures. To the extent the Company were to prevail in matters for which accruals have been established or be required to pay amounts in excess of reserves, the Company s effective tax rate in a given financial statement period could be materially affected. As of November 30 and August 31, 2006, the Company had recorded within other accrued expenses a total of $8.6 million and $8.3 million, respectively, for income and other tax related contingencies.

The Company is currently evaluating the impact, if any, of the adoption of FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes , which provides guidance associated with the recognition and measurement of tax positions and related reporting and disclosure requirements.

Table of Contents

NOTE 10 SHORT-TERM BORROWINGS AND LONG-TERM DEBT

As of November 30, 2006 and August 31, 2006, the Company, together with its majority or wholly-owned subsidiaries, had $677,000 and $158,000, respectively, outstanding in short-term borrowings, at weighted-average interest rates of 8.0% and 8.0%, respectively, which are secured by certain assets of the Company and its subsidiaries and are guaranteed by the Company. Each of the facilities expires during the year and is typically renewed. As of November 30, 2006 and August 31, 2006, the Company had approximately $11.0 million and $11.0 million available on these facilities, respectively.

Additionally, the Company has a bank credit agreement, secured by short-term restricted cash, for up to $7.0 million, which can be used as a line of credit or to issue letters of credit. As of November 30, 2006, letters of credit totaling $2.5 million were outstanding under this facility, leaving availability under this facility of $4.5 million.

As of November 30, 2006 and August 31, 2006, the Company, together with its majority or wholly owned subsidiaries, had $1.6 million and $18.7 million, respectively, outstanding in long-term borrowings. The carrying amount of the non-cash assets (land, building, fixtures, and equipment) assigned as collateral for long-term debt was $2.3 million and $27.9 million as of November 30, 2006 and August 31, 2006, respectively. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.

During the first quarter of fiscal 2007, the Company repaid the remaining balance on the long-term debt held by the International Finance Corporation. This debt had a remaining principal balance of $14.9 million at the time of repayment with semi-annual principal payments due through 2010.

NOTE 11 ACQUISITION OF MINORITY INTEREST

The Company s business combinations are accounted for under the purchase method of accounting, and include the results of operations of the acquired business from the date of acquisition. Net assets of the acquired business are recorded at their fair value at the date of the acquisition. The excess of the purchase price over the fair value of tangible net assets acquired is included in goodwill in the accompanying consolidated balance sheets.

During fiscal 2006, the Company purchased the minority interests of its Jamaica subsidiary in order to strengthen the Company s position for the future and consequently increased its ownership percentage in its Jamaica subsidiary from 67.5% to 100%. The Company acquired the minority interests of its three partners, Big Box Sales, Ltd., Chancellor Holdings Limited, and P.S.C., SA, whose ownership percentages were 15%, 10% and 7.5% respectively, on November 17, 2005, November 15, 2005, and December 23, 2005, respectively. The consideration provided in connection with this acquisition consisted of $2.4 million in cash and forgiveness of a $413,000 note receivable. The purchase price of $2.8 million was allocated to minority interest of $556,000, $126,000 to buildings and $2.1 million to goodwill. Also, during the second quarter of fiscal year 2006, the Company purchased a 5% minority interest of its Trinidad subsidiary from one of its partners and thereby increased its ownership percentage in its Trinidad subsidiary from 90% to 95%. The consideration provided in connection with this acquisition was $300,000. The purchase price was allocated to minority interest of $132,000 and $168,000 to goodwill. The goodwill related to these transactions has been allocated to the Caribbean Operations segment.

Table of Contents

NOTE 12 UNCONSOLIDATED AFFILIATE

In January 2002, the Company entered into a joint venture agreement with Grupo Gigante, S.A. de C.V. (Gigante) to initially open four PriceSmart warehouse clubs in Mexico. The Company and Gigante contributed $20.0 million each for a total of $40.0 million, and each owned 50% of the operations in PSMT Mexico, S.A. de C.V. (PSMT Mexico). The Company accounts for this investment under the equity method of accounting, in which the Company reflects its proportionate share of the income or loss from the joint venture. Three warehouse clubs were eventually opened during fiscal year 2003.

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, the Company recorded a non-cash charge of $3.1 million to reduce the Company s Investment in unconsolidated affiliate.

On February 11, 2005, it was announced that the Company and Gigante had decided to close the warehouse club operations of PSMT Mexico and the closure was completed on February 28, 2005. The joint venture sold two of the three warehouse clubs, consisting of land and buildings, in September 2005 for an aggregate price of $11.2 million. One warehouse club remains unsold, although efforts are underway to sell it as well. The fixtures and equipment are also being sold. The Company has purchased approximately $2.3 million of fixtures from PSMT Mexico as of November 30, 2006. The Company paid $750,000 in cash and offset the remainder with receivables and a note owed by PSMT Mexico to the Company.

	As of November 30, 2006	As of August 31, 2006
Current assets	$ 6,118	$ 5,887
Noncurrent assets	$ 5,692	$ 7,038
Current liabilities	$ 890	$ 839
Noncurrent liabilities	$ 66	$

	Three Months Ended November 30, 2006	2005
Revenues	$	$ 49
Cost of Goods Sold	$	