PRICESMART INC
Form 10-Q
April 07, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended February 29, 2016

OR

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

For the transition period from to

COMMISSION FILE NUMBER 0-22793

PriceSmart, Inc.

(Exact name of registrant as specified in its charter)

Delaware	33-0628530
(State or other jurisdiction of 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 No

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

Yes No

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

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

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

Yes No

The registrant had 30,371,082 shares of its common stock, par value $0.0001 per share, outstanding at March 31, 2016.

PRICESMART, INC.

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PriceSmart, Inc.'s ("PriceSmart," "we" or the "Company") unaudited consolidated balance sheet as of February 29, 2016 and the consolidated balance sheet as of August 31, 2015, the unaudited consolidated statements of income for the three and six months ended February 29, 2016 and February 28, 2015, the unaudited consolidated statements of comprehensive income for the three and six months ended February 29, 2016 and February 28, 2015, the unaudited consolidated statements of equity for the six month ended February 29, 2016 and February 28, 2015, and the unaudited consolidated statements of cash flows for the six month ended February 29, 2016 and February 28, 2015, are included herein. Also included herein are the notes to the unaudited consolidated financial statements.

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PRICESMART, INC.

CONSOLIDATED BALANCE SHEETS

(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

	February 29, 2016 (Unaudited)	August 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 173,008	$ 157,072
Short-term restricted cash	135	61
Receivables, net of allowance for doubtful accounts of $0 as of February 29, 2016 and August 31, 2015, respectively	7,178	9,662
Merchandise inventories	260,101	267,175
Prepaid expenses and other current assets	24,366	22,535
Total current assets	464,788	456,505
Long-term restricted cash	2,360	1,464
Property and equipment, net	440,523	433,040
Goodwill	35,701	35,871
Deferred tax assets – long term	13,648	14,845
Other non-current assets (includes $4,735 and $4,129 as of February 29, 2016 and August 31, 2015, respectively, for the fair value of derivative instruments)	41,012	39,182
Investment in unconsolidated affiliates	10,811	10,317
Total Assets	$ 1,008,843	$ 991,224
LIABILITIES AND EQUITY		
Current Liabilities:		
Short-term borrowings	$ —	$ 6,606
Accounts payable	237,810	241,978
Accrued salaries and benefits	15,124	17,977
Deferred membership income	21,804	20,184
Income taxes payable	6,398	9,595
Other accrued expenses (includes $216 and $66 as of February 29, 2016 and August 31, 2015, respectively, for the fair value of foreign currency forward contracts)	22,649	23,558
Dividends payable	10,629	—
Long-term debt, current portion	16,018	17,169
Total current liabilities	330,432	337,067
Deferred tax liability – long-term	1,544	1,755
Long-term portion of deferred rent	8,253	6,595
Long-term income taxes payable, net of current portion	1,050	1,402
Long-term debt, net of current portion	75,047	73,365
	5,548	4,456

Other long-term liabilities (includes $1,977 and $1,699 for the fair value of derivative instruments and $3,571 and $2,757 for post employment plans as of February 29, 2016 and August 31, 2015, respectively)		
Total Liabilities	421,874	424,640

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Equity:		
Common stock, $0.0001 par value, 45,000,000 shares authorized; 31,189,728 and 30,977,764 shares issued and 30,369,911 and 30,184,584 shares outstanding (net of treasury shares) as of February 29, 2016 and August 31, 2015, respectively	3	3
Additional paid-in capital	407,826	403,168
Tax benefit from stock-based compensation	11,269	10,711
Accumulated other comprehensive loss	(112,743)	(101,512)
Retained earnings	311,967	283,611
Less: treasury stock at cost; 819,817 shares as of February 29, 2016 and 793,180 shares as of August 31, 2015	(31,353)	(29,397)
Total Equity	586,969	566,584
Total Liabilities and Equity	$ 1,008,843	$ 991,224

See accompanying notes.

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PRICESMART, INC.

CONSOLIDATED STATEMENTS OF INCOME

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

	Three Months Ended		Six Months Ended	
	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
Revenues:				
Net warehouse club sales	$ 758,987	$ 732,120	$ 1,449,818	$ 1,368,535
Export sales	6,549	6,229	14,781	14,660
Membership income	11,285	10,898	22,751	21,013
Other income	1,110	1,049	2,512	2,109
Total revenues	777,931	750,296	1,489,862	1,406,317
Operating expenses:				
Cost of goods sold:				
Net warehouse club	651,500	625,876	1,241,683	1,164,904
Export	6,225	5,934	14,057	13,961
Selling, general and administrative:				
Warehouse club operations	64,763	62,041	125,603	118,251
General and administrative	16,184	14,117	31,647	27,467
Pre-opening expenses	71	229	376	3,378
Loss/(gain) on disposal of assets	52	391	65	363
Total operating expenses	738,795	708,588	1,413,431	1,328,324
Operating income	39,136	41,708	76,431	77,993
Other income (expense):				
Interest income	280	266	458	530
Interest expense	(1,536)	(1,970)	(2,909)	(3,144)
Other income (expense), net	(552)	(1,659)	(796)	(4,291)
Total other income (expense)	(1,808)	(3,363)	(3,247)	(6,905)
Income before provision for income taxes and income (loss) of unconsolidated affiliates	37,328	38,345	73,184	71,088
Provision for income taxes	(11,815)	(13,526)	(23,945)	(25,628)
Income (loss) of unconsolidated affiliates	429	16	375	22
Net income	25,942	$ 24,835	$ 49,614	45,482
Net income per share available for distribution:				
Basic net income per share	$ 0.85	$ 0.82	$ 1.63	$ 1.50
Diluted net income per share	$ 0.85	$ 0.82	$ 1.63	$ 1.50
Shares used in per share computations:				
Basic	29,914	29,827	29,902	29,809

Diluted	29,919	29,833	29,907	29,816
Dividends per share	$ 0.70	$ 0.70	$ 0.70	$ 0.70

See accompanying notes.

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PRICESMART, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Three Months Ended		Six Months Ended	
	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
Net income	$ 25,942	$ 24,835	$ 49,614	$ 45,482
Other Comprehensive Income, net of tax:				
Foreign currency translation adjustments (1)	$ (10,420)	$ (10,906)	$ (10,892)	$ (22,557)
Defined benefit pension plan:				
Amortization of prior service cost and actuarial gains included in net periodic pensions cost	(4)	(13)	(8)	(24)
Total defined benefit pension plan	(4)	(13)	(8)	(24)
Derivative instruments: (2)				
Unrealized gains/(losses) on change in fair value of interest rate swaps	(211)	1,225	(331)	3,468
Total derivative instruments	(211)	1,225	(331)	3,468
Other comprehensive income (loss)	(10,635)	(9,694)	(11,231)	(19,113)
Comprehensive income	$ 15,307	$ 15,141	$ 38,383	$ 26,369

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

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

See accompanying notes.

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PRICESMART, INC.

CONSOLIDATED STATEMENTS OF EQUITY

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Common Stock Shares	Amount	Additional Paid-in Capital	Tax Benefit From Stock Based Compensation	Accumulated Other Comprehensive Income(Loss)	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Total Equity
Balance at August 31, 2014	30,951	$ 3	$ 397,150	$ 9,505	$ (49,286)	$ 215,613	741	$ (24,720)	$ 548,265
Purchase of treasury stock	—	—	—	—	—	—	50	(4,441)	(4,441)
Issuance of restricted stock award	20	—	—	—	—	—	—	—	—
Exercise of stock options	3	—	49	—	—	—	—	—	49
Stock-based compensation	—	—	3,340	1,457	—	—	—	—	4,797
Dividend paid to stockholders	—	—	—	—	—	(10,564)	—	—	(10,564)
Dividend payable to stockholders	—	—	—	—	—	(10,564)	—	—	(10,564)
Net income	—	—	—	—	—	45,482	—	—	45,482
Other comprehensive income (loss)	—	—	—	—	(19,113)	—	—	—	(19,113)
Balance at February 28, 2015	30,974	$ 3	$ 400,539	$ 10,962	$ (68,399)	$ 239,967	791	$ (29,161)	$ 553,911
Balance at August 31, 2015	30,978	$ 3	$ 403,168	$ 10,711	$ (101,512)	$ 283,611	793	$ (29,397)	$ 566,584
Purchase of treasury stock	—	—	—	—	—	—	27	(1,956)	(1,956)
	208	—	—	—	—	—	—	—	—

Issuance of restricted stock award									
Exercise of stock options	—	—	80	—	—	—	—	—	80
Stock-based compensation	4	—	4,578	558	—	—	—	—	5,136
Dividend paid to stockholders	—	—	—	—	—	(10,629)	—	—	(10,629)
Dividend payable to stockholders	—	—	—	—	—	(10,629)	—	—	(10,629)
Net income	—	—	—	—	—	49,614	—	—	49,614
Other comprehensive income (loss)	—	—	—	—	(11,231)	—	—	—	(11,231)
Balance at February 29, 2016	31,190	$ 3	$ 407,826	$ 11,269	$ (112,743)	$ 311,967	820	$ (31,353)	$ 586,969

See accompanying notes.

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PRICESMART, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED—AMOUNTS IN THOUSANDS)

	Six Months Ended	
	February 29, 2016	February 28, 2015
Operating Activities:		
Net income	$ 49,614	$ 45,482
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,732	16,433
Allowance for doubtful accounts	—	5
(Gain)/loss on sale of property and equipment	65	363
Deferred income taxes	16	2,478
Excess tax benefit on stock-based compensation	(558)	(1,457)
Equity in (gains) losses of unconsolidated affiliates	(375)	(22)
Stock-based compensation	4,578	3,340
Change in operating assets and liabilities:		
Receivables, prepaid expenses and other current assets, accrued salaries and benefits, deferred membership income and other accruals	(3,824)	(7,836)
Merchandise inventories	7,074	(54,873)
Accounts payable	(5,742)	8,031
Net cash provided by (used in) operating activities	69,580	11,944
Investing Activities:		
Additions to property and equipment	(32,177)	(42,160)
Deposits for land purchase option agreements	(75)	(348)
Proceeds from disposal of property and equipment	129	40
Investment in joint ventures	(119)	(1,360)
Net cash provided by (used in) investing activities	(32,242)	(43,828)
Financing Activities:		
Proceeds from long-term bank borrowings	7,370	36,977
Repayment of long-term bank borrowings	(6,747)	(16,658)
Proceeds from short-term bank borrowings	5,650	34,970
Repayment of short-term bank borrowings	(12,204)	(28,868)
Cash dividend payments	(10,629)	(10,564)
Release of restricted cash	—	2,920
Excess tax benefit on stock-based compensation	558	1,457
Purchase of treasury stock	(1,956)	(4,441)
Proceeds from exercise of stock options	80	49
Net cash provided by (used in) financing activities	(17,878)	15,842
Effect of exchange rate changes on cash and cash equivalents	(3,524)	(1,813)

Net increase (decrease) in cash and cash equivalents	15,936	(17,855)
Cash and cash equivalents at beginning of period	157,072	137,098
Cash and cash equivalents at end of period	$ 173,008	$ 119,243
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest, net of amounts capitalized	$ 2,836	$ 2,755
Income taxes	$ 26,701	$ 22,212
Dividends declared but not paid	$ 10,629	$ 10,564

See accompanying notes.

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

February 29, 2016

NOTE 1 – COMPANY OVERVIEW AND BASIS OF PRESENTATION

PriceSmart, Inc.'s ("PriceSmart" or the "Company") business consists primarily of international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. As of February 29, 2016, the Company had 38 consolidated warehouse clubs in operation in 12 countries and one U.S. territory (six in Costa Rica and Colombia; five in Panama; four in Trinidad; three in Guatemala, Honduras and the Dominican Republic; two in El Salvador and Nicaragua; and one each in Aruba, Barbados, Jamaica, and the United States Virgin Islands), of which the Company owns 100% of the corresponding legal entities (see Note 2 - Summary of Significant Accounting Policies). In January 2014, the Company acquired land in Pereira, Colombia and in the city of Medellin, Colombia and leased land in the city of Bogota, Colombia. The Company built new warehouse clubs at these three sites, and opened the Bogota location in October 2014 and opened the other two sites in November 2014. Together with the three warehouse clubs that were operating prior to these openings in Colombia (one in Barranquilla and two in Cali), these three new clubs brought the number of PriceSmart warehouse clubs operating in Colombia to six. In September 2014, the Company acquired land in La Chorrera ("Costa Verde"), west of Panama City, Panama, on which the Company opened its fifth PriceSmart warehouse club in Panama in June 2015. In April 2015, the Company acquired land in Managua, Nicaragua. The Company constructed and opened a warehouse club on this site in November 2015. The Company purchased land in Chia, a city north of Bogota, Colombia where it is currently constructing a new warehouse club that is expected to open in September 2016. On December 4, 2015 the Company signed an option to acquire two properties and then swap them for 59,353 square feet of land adjacent to our San Pedro Sula warehouse club in Honduras. If the option is exercised, the parcels will be used to expand the parking lot for the warehouse club. The Company continues to explore other potential sites for future warehouse clubs in Central America, the Caribbean and Colombia.

Basis of Presentation - The interim consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2015 (the "2015 Form 10-K"). The interim consolidated financial statements include the accounts of PriceSmart, Inc., a Delaware corporation, and its subsidiaries. Inter-company transactions between the Company and its subsidiaries have been eliminated in consolidation.

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

Reclassifications to consolidated balance sheet recorded during fiscal year 2016 for fiscal year 2015 – Certain reclassifications to the consolidated balance sheet have been made to prior fiscal year amounts to conform to the presentation in the current fiscal year.

The Company early adopted ASU 2015-17 as of February 29, 2016 with retrospective application to prior periods. Accordingly, the Company reclassified current deferred tax assets and liabilities to noncurrent on its consolidated balance sheet reported for fiscal year ended 2015, which increased noncurrent deferred tax assets by $7.4 million and decreased noncurrent deferred tax liabilities by $438,000.

	August 31, 2015 balance sheet line item as previously reported	Amount reclassified	August 31, 2015 balance sheet line item as currently reported
Deferred tax asset- current	$ 7,849	$ (7,849)	$ -
Deferred tax asset- long term	$ 7,464	$ 7,381	$ 14,845
Deferred tax liability- current	$ 30	$ (30)	$ -
Deferred tax liability- long term	$ 2,193	$ (438)	$ 1,755

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation – The interim consolidated financial statements of the Company included herein include the assets, liabilities and results of operations of the Company’s wholly owned subsidiaries and the Company's investment in, and the Company's share of the income (loss) of, joint ventures recorded under the equity method. All significant inter-company accounts and transactions have been eliminated in consolidation. The interim consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the SEC and reflect all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary to fairly present the financial position, results of operations, and cash flows for the periods presented. The results for interim periods are not necessarily indicative of the results for the full year. As of February 29, 2016, all of the Company's subsidiaries were wholly owned. Additionally, the Company's ownership interest in real estate development joint ventures as of February 29, 2016 is listed below:

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

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

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

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

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

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

	February 29, 2016	August 31, 2015
Short-term restricted cash:		
Other short-term restricted cash (1)	$ 135	$ 61
Total short-term restricted cash	$ 135	$ 61
Long-term restricted cash:		
Other long-term restricted cash (1)	$ 2,360	$ 1,464
Total long-term restricted cash	$ 2,360	$ 1,464
Total restricted cash	$ 2,495	$ 1,525

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

Tax Receivables - The Company pays Value Added Tax (“VAT”) or similar taxes (“input VAT”), income taxes, and other taxes within the normal course of its business in most of the countries in which it operates related to the procurement of merchandise and/or services it acquires and/or on sales and taxable income. The Company also collects VAT or similar taxes on behalf of the government (“output VAT”) for merchandise and/or services it sells. If the output VAT exceeds the input VAT, then the difference is remitted to the government, usually on a monthly basis. If the input VAT exceeds the output VAT, this creates a VAT receivable. In most countries where the Company operates, the governments have implemented additional collection procedures, such as requiring credit card processors to remit a portion of sales processed via credit card directly to the government

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

as advance payments of VAT and/or income tax. In the case of VAT, these procedures alter the natural offset of input and output VAT and generally leave the Company with a net VAT receivable, forcing the Company to process significant refund claims on a recurring basis. With respect to income taxes paid, if the estimated income taxes paid or withheld exceed the actual income tax due, this creates an income tax receivable. The Company either requests a refund of these tax receivables or applies the balance to expected future tax payments. These refund or offset processes can take anywhere from several months to several years to complete.

In most countries where the Company operates, the tax refund process is defined and structured with regular refunds or offsets. However, in two countries the governments have alleged that there is no defined process in the law to allow them to refund VAT receivables. The Company, together with its tax and legal advisers, is currently appealing these interpretations in court and expects to prevail. In one of these countries, where there is recent favorable jurisprudence, the government performed an audit to verify the amount of the respective VAT receivables as a required precursor to any refund. The balance of the VAT receivable in these countries was $6.6 million and $6.5 million as of February 29, 2016 and August 31, 2015, respectively. In another country in which the Company has warehouse clubs, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires the Company to pay taxes based on a percentage of sales rather than income. As a result, the Company is making income tax payments substantially in excess of those it would expect to pay based on taxable income. The current rules (which the Company has challenged in court) do not clearly allow the Company to obtain a refund or offset this excess income tax against other taxes. As of February 29, 2016, the Company had deferred tax assets of approximately $1.7 million in this country. Also, the Company had an income tax receivable balance of $1.8 million as of February 29, 2016 related to excess payments from fiscal years 2015 and 2016. The Company has not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets, because the Company believes that it is more likely than not that it will succeed in its refund request and/or court challenge on this matter.

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

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

- Long-term VAT and Income tax receivables, recorded as Other non-current assets: This classification is used for amounts not approved for refund or credit in countries where the Company's subsidiary has not demonstrated the ability to obtain refunds within one year and/or for amounts which are subject to outstanding disputes. An allowance is provided against VAT and income tax receivable balances in dispute when the Company does not expect to eventually prevail in its recovery.

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

	February 29, 2016	August 31, 2015
Prepaid expenses and other current assets	$ 6,406	$ 4,673
Other non-current assets	23,944	22,239
Total amount of VAT receivable reported	$ 30,350	$ 26,912

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

	February 29, 2016	August 31, 2015
Prepaid expenses and other current assets	$ 3,158	$ 2,941
Other non-current assets	8,370	8,772
Total amount of income tax receivable reported	$ 11,528	$ 11,713

Lease Accounting – Certain of the Company's operating leases where the Company is the lessee (see Revenue Recognition Policy for lessor accounting) provide for minimum annual payments that increase over the expected life of the lease. The aggregate minimum annual payments are expensed on the straight-line basis beginning when the Company takes possession of the property and extending over the expected term of the related lease including renewal options when the exercise of the option is reasonably assured as an economic penalty may be incurred if the option is not exercised. The amount by which straight-

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

line rent exceeds actual lease payment requirements in the early years of the leases is accrued as deferred rent and reduced in later years when the actual cash payment requirements exceed the straight-line expense. The Company also accounts in its straight-line computation for the effect of any “rental holidays” and lessor-paid tenant improvements. In addition to the minimum annual payments, in certain locations, the Company pays additional contingent rent based on a contractually stipulated percentage of sales.

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

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

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

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

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

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

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

Long-term restricted cash: Long-term restricted cash primarily consists of auto renewable 3-12 month certificates of deposit, which are held as collateral against our long-term debt. The carrying value approximates fair value due to the maturity of the underlying certificates of deposit within the normal operating cycle of the Company.

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

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

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

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

Long-term debt: The fair value of debt is generally measured using a discounted cash flow analysis based on current market interest rates for similar types of financial instruments. These inputs are not quoted prices in active markets but

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they are either directly or indirectly observable; therefore, they are classified as Level 2 inputs. The carrying value and fair value of the Company's debt as of February 29, 2016 and August 31, 2015 is as follows (in thousands):

	February 29, 2016		August 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt, including current portion	$ 91,065	$ 89,002	$ 90,534	$ 88,307

(1) The Company has disclosed the fair value of long-term debt, including debt for which it has entered into cross-currency interest rate swaps, using the derivative obligation as of February 29, 2016 and August 31, 2015, to estimate the fair value of long-term debt, which includes the effects that the cross-currency interest rate swaps have had on the fair value of long-term debt.

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

Cash Flow Instruments. The Company is a party to receive floating interest rate, pay fixed-rate interest rate swaps to hedge the interest rate risk of certain U.S. dollar denominated debt within its international subsidiaries. The swaps are designated as cash flow hedges of interest expense risk. These instruments are considered effective hedges and are recorded using hedge accounting. The Company is also a party to receive variable interest rate, pay fixed interest rate cross-currency interest rate swaps to hedge the interest rate and currency exposure associated with the expected payments of principal and interest of U.S. denominated debt within its international subsidiaries whose functional currency is other than the U.S. dollar. The swaps are designated as cash flow hedges of the currency risk related to payments on the U.S. denominated debt. These instruments are also considered to be effective hedges and are recorded using hedge accounting. Under cash flow hedging, the effective portion of the fair value of the derivative, calculated as the net present value of the future cash flows, is deferred on the consolidated balance sheets in accumulated other comprehensive loss. If any portion of an interest rate swap is determined to be an ineffective hedge, the gains or losses from changes in fair value would be recorded directly in the consolidated statements of income. Amounts recorded in accumulated other comprehensive loss are released to earnings in the same period that the hedged transaction impacts consolidated earnings. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of interest rate swaps and cross-currency interest rate swaps as of February 29, 2016 and August 31, 2015.

Fair Value Instruments. The Company is exposed to foreign-currency exchange rate fluctuations in the normal course of business. The Company is also exposed to foreign-currency exchange rate fluctuations on U.S. dollar denominated liabilities within its international subsidiaries whose functional currency is other than the U.S. dollar. The Company manages these fluctuations, in part, through the use of non-deliverable forward foreign-exchange contracts that are intended to offset changes in cash flow attributable to currency exchange movements. The contracts are intended primarily to economically address exposure to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries whose functional currency is other than the U.S. dollar. Currently, these contracts are treated for accounting purposes as fair value instruments and do not qualify for derivative hedge accounting, and as such the Company does not apply derivative hedge accounting to record these transactions. As a result, these contracts are valued at fair value with unrealized gains or losses reported in earnings during the period of the change. The Company seeks to mitigate foreign-currency exchange-rate risk with the use of these contracts and does not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features and are limited to less than one year in duration. See Note 9 - Derivative Instruments and Hedging Activities for information on the fair value of open, unsettled forward foreign-exchange contracts as of February 29, 2016 and August 31, 2015.

Early Settlement of Derivative Instruments Qualifying for Hedge Accounting. During the fourth quarter of fiscal year 2015, the Company's Colombia subsidiary paid off the outstanding principal balance of U.S. $24.0 million on loan agreements

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PRICESMART, INC.

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that were entered into by the subsidiary with Scotiabank & Trust (Cayman) Ltd before the scheduled loan payment dates. The Company's Colombia subsidiary also settled the cross-currency interest rate swaps that it had entered into with the Bank of Nova Scotia ("Scotia Bank") related to these loans during the fourth quarter of fiscal year 2015. As indicated above, for a derivative instrument to qualify for cash flow hedge accounting there must be an expectation that the derivative instrument will be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. As part of the determination that a derivative instrument is highly effective at offsetting the exposure, the Company must determine that that the forecasted transaction will occur; therefore, an entity's past ability to accurately predict forecasted transactions should be considered when determining if a hedged transaction qualifies for cash flow hedge accounting. To the extent an entity has developed a pattern of changing the probability of occurrence of forecasted transactions, the ability of the entity to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions would be called into question. The Company believes that the settlements of these derivatives does not demonstrate such a pattern and does not disqualify the Company from the application of hedge accounting for the remaining hedging instruments and underlying loans whose terms and conditions remain unchanged. The Company classifies cash payments or proceeds from termination of derivatives as net cash provided by (used in) operating activities within the consolidated statements of cash flows.

The following tables summarize financial assets and liabilities measured and recorded at fair value on a recurring basis in the Company's consolidated balance sheet as of February 29, 2016 and August 31, 2015 (in thousands) for derivatives that qualify for hedge accounting:

Assets and Liabilities as of February 29, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other non-current assets – (Cross-currency interest rate swaps)	$ —	$ 4,735	$ —	$ 4,735
Other long-term liabilities – (Interest rate swaps)	—	(641)	—	(641)
Other long-term liabilities – (Cross-currency interest rate swaps)	—	(1,336)	—	(1,336)

Total	$	—	$	2,758	$	—	$	2,758

Assets and Liabilities as of August 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)		Total	
Other non-current assets – (Cross-currency interest rate swaps)	$	—	$	4,129	$	—	$	4,129
Other long-term liabilities – (Interest rate swaps)		—		(387)		—		(387)
Other long-term liabilities – (Cross-currency interest rate swaps)		—		(1,312)		—		(1,312)
Total	$	—	$	2,430	$	—	$	2,430

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following tables summarize financial assets and liabilities measured and recorded at fair value on a recurring basis in the Company's consolidated balance sheet as of February 29, 2016 and August 31, 2015 (in thousands) for derivatives that do not qualify for hedge accounting:

Assets and Liabilities as of February 29, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other accrued expenses (Foreign currency forward contracts)	$ —	$ (216)	$ —	$ (216)
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting	$ —	$ (216)	$ —	$ (216)

Assets and Liabilities as of August 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other accrued expenses (Foreign currency forward contracts)	$ —	$ (66)	$ —	$ (66)
Net fair value of derivatives designated as hedging instruments that do not qualify for hedge accounting	$ —	$ (66)	$ —	$ (66)

Goodwill – The table below presents goodwill resulting from certain business combinations as of February 29, 2016 and August 31, 2015 (in thousands). The change in goodwill is a result of foreign exchange translation losses.

	February 29, 2016	August 31, 2015	Change
Goodwill	$ 35,701	$ 35,871	$ (170)

The Company reviews goodwill at the entity level for impairment. The Company first reviews qualitative factors for each reporting unit, in determining if an annual goodwill test is required. If the Company's review of qualitative factors indicates a requirement for a test of goodwill impairment, the Company then will assess whether the carrying amount of a reporting unit is greater than zero and exceeds its fair value established during the Company's prior test of goodwill impairment ("established fair value"). If the carrying amount of a reporting unit at the entity level is greater than zero and its established fair value exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If either the carrying amount of the reporting unit is not greater than zero or if the carrying amount of the entity exceeds its established fair value, the Company performs a second test to determine whether goodwill has been impaired and to calculate the amount of that impairment.

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

The Company began offering Platinum memberships in Costa Rica during fiscal year 2013, which provides members with a 2% rebate on most items, up to an annual maximum of $500.00. Platinum members can apply this rebate to future purchases at the warehouse club at the end of the annual membership period. The Company records this 2% rebate as a reduction of revenue at the time of the sales transaction. Accordingly, the Company has reduced warehouse sales and has accrued a liability within other accrued expenses. The rebate is issued annually to Platinum members on March 1 and expires August 31. Any rebate amount not redeemed by August 31 is recognized as breakage revenue. The Company periodically reviews expired unused rebates outstanding, and the expired unused rebates are recognized as Revenues: Other income on the consolidated statements of income.   The Company has determined that breakage revenue is insignificant; therefore, it records 100% of the Platinum membership liability at the time of sale, rather than estimating breakage.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

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

The Company’s Guatemala Pradera warehouse club experienced a fire in its merchandise receiving department during the early morning hours of June 4, 2015. No members or employees were in the warehouse club at the time. The fire was extinguished, but caused considerable smoke and some fire damage. The warehouse club was closed for nine days and reopened on June 13, 2015. The Company is insured for these costs and filed an insurance claim with its insurance provider. During the quarter ended August 31, 2015, the Company recorded an initial receivable of approximately $2.8 million against the expected insurance payment related to expenses associated with the write off of inventory, equipment disposals, building repairs, other associated costs recognized related to the fire and for current replacement costs for assets lost in the fire in excess of the net book value (disposal cost). The Company received as of August 31, 2015 approximately $300,000 in payments against the claim filed and the receivable recorded. Of this amount, approximately $76,000 was recorded as a gain on disposal of assets, as proceeds received from the insurance reimbursement were in excess of the amount of loss recognized on the disposal of assets. Additionally, the Company recorded approximately $28,000 for the disposal of assets damaged during the fire, for which it had not yet been reimbursed. As of August 31, 2015, the Company's receivable related to this insurance claim was approximately $2.6 million. The Company’s insurance policy also addresses coverage for business interruption. During the fourth quarter of fiscal year 2015, the Company filed a claim with its insurance carrier for approximately $332,000 related to business interruption for which the Company did not record a receivable. Insurance proceeds for reimbursements related to business interruptions are considered gain contingencies and are not recognized in the financial statements until the period in which all contingencies are resolved and the gain is realized. During the fourth quarter of fiscal year 2015, the Company expensed to cost of goods sold, net warehouse club expenses of approximately $165,000 related to the write off of inventory not covered by insurance. Additionally, the Company expensed to selling, general and administrative expenses approximately $34,000 in salaries related to the clean up and preparation of the warehouse club for reopening.

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

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

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

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

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

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

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

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

The following table summarizes the amounts recorded for the three and six month periods ending February 29, 2016 and February 28, 2015 (in thousands):

	Three Months Ended		Six Months Ended	
	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
Currency gain (loss)	$ (552)	$ (1,659)	$ (796)	$ (4,291)

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

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

The Company accrues an amount for its estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained. This requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. When facts and circumstances change, the Company reassesses these probabilities and records any changes in the consolidated financial statements as appropriate. There were no material changes in the Company's uncertain income tax positions as of February 29, 2016 and August 31, 2015. During the first quarter of fiscal year 2015, one of the Company’s subsidiaries received provisional assessments claiming $2.5 million of taxes, penalties and interest related to withholding taxes on certain charges for services rendered by the Company. In addition, this subsidiary received provisional assessments totaling $5.2 million for lack of deductibility of the underlying service charges due to the lack of withholding. Based on a review of the Company's tax advisers' interpretation of local law, rulings and jurisprudence (including Supreme Court precedents with respect to the deductibility assessment), the Company expects to prevail in both instances and has not recorded a provision for these assessments. Also, in another country, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires the Company to pay taxes based on a percentage of sales rather than income. As a result, the Company is making income tax payments substantially in excess of those it would expect to pay based on taxable income. The current rules (which the Company has challenged in court) do not clearly allow the Company to obtain a refund or offset this excess income tax against other taxes. As of February 29, 2016, the Company had deferred tax assets of approximately $1.7 million in this country. Also, the Company had an income tax receivable balance of $1.8 million as of February 29, 2016 related to excess payments from fiscal years 2015 and 2016. The Company has not placed any type of allowance on the recoverability of these tax receivables or deferred tax assets, because the Company believes that it is more likely than not that it will succeed in its refund request and/or court challenge on this matter.

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

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

	Three Months Ended		Six Months Ended	
	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
Federal tax provision at statutory rates	35.0 %	35.0 %	35.0 %	35.0 %
State taxes, net of federal benefit	0.3	0.3	0.3	0.4
Differences in foreign tax rates	(5.0)	(4.1)	(4.5)	(4.2)
Permanent items and other adjustments	0.4	2.9	0.8	2.9
Increase (decrease) in foreign valuation allowance	1.0	1.2	1.1	2.0
Provision for income taxes	31.7 %	35.3 %	32.7 %	36.1 %

The variance in the effective tax rate for the three-month period ended on February 29, 2016 compared to the same period of the prior year was primarily attributable to the following factors: (i) the favorable impact of 1.2% resulting from a decreased taxable loss incurred in the Company's Colombia subsidiary for which no tax benefit was recognized, net of adjustment to valuation allowance; (ii) the favorable impact of 1.1% in the current period from the tax effect of changes in foreign currency value; (iii) the favorable impact of 1.1% due to the relative decrease in U.S. taxable income, which is taxed at a higher statutory tax rate compared to tax rates in foreign jurisdictions.

The variance in the effective tax rate for the six-month period ended February 29, 2016 compared to the prior year was primarily attributable to the favorable impact of 2.2% resulting from a decreased taxable loss incurred in the Company's Colombia subsidiary for which no tax benefit was recognized, net of adjustment to valuation allowance, and the favorable impact of 0.7% in the current period from the tax effect of changes in foreign currency value.

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Recent Accounting Pronouncements

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

On March 31, 2016, the Financial Accounting Standards Board ("FASB") issued amendments to the guidance on employee share-based payment accounting intended to improve the accounting for employee share-based payments. This ASU, simplifies several aspects of the accounting for share-based payment award transactions, including:

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

The amendments in this ASU are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any organization in any interim or annual period. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

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

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

The amendment in this ASU is effective on a prospective or retrospective basis for public entities for fiscal years and interim periods within those annual periods beginning after December 15, 2018. Early adoption is permitted. The Company will evaluate the impact adoption of this guidance may have on the Company's consolidated financial statements.

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

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

The amendment in this ASU is effective on a prospective or retrospective basis for public entities for fiscal years and interim periods within those annual periods beginning after December 15, 2016. Early adoption is allowed. The Company has elected early adoption of this amendment to the guidance. The Company has re-classified all deferred tax assets and liabilities as noncurrent. See Note 1 for details.

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

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

The amendment in this ASU is effective on a prospective basis for public entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early application is permitted as of the beginning of an interim or annual reporting period. Adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

FASB ASC 350 ASU 2015-05 - Customers accounting for fees paid in a cloud computing arrangement

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

The amendments in this ASU are effective for public entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity can elect to adopt the amendments either: (1) prospectively to all arrangements entered into or materially modified after the effective date; or (2) retrospectively. Adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

FASB ASC 606 ASU 2014-09 - Revenue from contracts with customers.

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

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

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

NOTE 3 – PROPERTY AND EQUIPMENT

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

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

	February 29, 2016	August 31, 2015
Land	$ 126,918	$ 128,071
Building and improvements	290,343	278,982
Fixtures and equipment	176,509	164,916
Construction in progress	28,105	26,679
Total property and equipment, historical cost	621,875	598,648
Less: accumulated depreciation	(181,352)	(165,608)
Property and equipment, net	$ 440,523	$ 433,040

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Depreciation and amortization expense (in thousands):

	Three Months Ended		Six Months Ended	
	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
Depreciation and amortization expense	$ 9,529	$ 8,636	$ 18,732	$ 16,433

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

Total interest capitalized (in thousands):

	As of	
	February 29, 2016	August 31, 2015
Total interest capitalized	$ 7,192	$ 6,961

Total interest capitalized (in thousands):

	Three Months Ended		Six Months Ended	
	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
Interest capitalized	$ 140	$ 147	$ 434	$ 763

The Company also recorded within accounts payable and other accrued expenses approximately $192,000 and $1.4 million respectively, as of February 29, 2016 and $458,000 and $1.5 million, respectively, as of August 31, 2015 of liabilities related to the acquisition and/or construction of property and equipment.

NOTE 4 – EARNINGS PER SHARE

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

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table sets forth the computation of net income per share for the three and six months ended February 29, 2016 and February 28, 2015 (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
Net income	$ 25,942	$ 24,835	$ 49,614	$ 45,482
Less: Allocation of income to unvested stockholders	(371)	(259)	(742)	(580)
Net earnings available to common stockholders	$ 25,571	$ 24,576	$ 48,872	$ 44,902
Basic weighted average shares outstanding	29,914	29,827	29,902	29,809
Add dilutive effect of stock options (two-class method)	5	6	5	7
Diluted average shares outstanding	29,919	29,833	29,907	29,816
Basic net income per share	$ 0.85	$ 0.82	$ 1.63	$ 1.50
Diluted net income per share	$ 0.85	$ 0.82	$ 1.63	$ 1.50

NOTE 5 – STOCKHOLDERS' EQUITY

Dividends

The following table summarizes the dividends declared and paid during fiscal year 2016 and 2015.

		First Payment				Second Payment			
Declared	Amount	Record Date	Date Paid	Date Payable	Amount	Record Date	Date Paid	Date Payable	Amount
2/3/2016	$ 0.70	2/15/2016	2/29/2016	N/A	$ 0.35	8/15/2016	N/A	8/31/2016	$ 0.35
2/4/2015	$ 0.70	2/13/2015	2/27/2015	N/A	$ 0.35	8/14/2015	8/31/2015	N/A	$ 0.35

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

Comprehensive Income and Accumulated Other Comprehensive Loss

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

	Six Months Ended February 29, 2016			
	Foreign currency translation adjustments	Defined benefit pension plans	Derivative Instruments	Total
Beginning balance, September 1, 2015	$ (100,540)	$ (113)	$ (859)	$ (101,512)
Other comprehensive income (loss)	(10,892)	—	(331)	(11,223)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(8) (2)	—	(8)
Ending balance, February 29, 2016	$ (111,432)	$ (121)	$ (1,190)	$ (112,743)

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Six Months Ended February 28, 2015					
	Foreign currency translation adjustments	Defined benefit pension plans		Derivative Instruments	Total
Beginning balance, September 1, 2014	$ (50,410)	$ 113		$ 1,011	$ (49,286)
Other comprehensive income (loss)	(22,557)	—		3,468	(19,089)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(24)	(2)	—	(24)
Ending balance, February 28, 2015	$ (72,967)	$ 89		$ 4,479	$ (68,399)

	Twelve Months Ended August 31, 2015					
	Foreign currency translation adjustments	Defined benefit pension plans		Derivative Instruments		Total
Beginning balance, September 1, 2014	$ (50,410)	$ 113		$ 1,011		$ (49,286)
Other comprehensive income (loss)	(50,130)	65		(1,770)		(51,835)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(291)	(2)	(100)	(1)(3)	(391)
Ending balance, August 31, 2015	$ (100,540)	$ (113)		$ (859)		$ (101,512)

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

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

(3) Amounts reclassified from accumulated other comprehensive income (loss) for settlement of derivative instruments are included in other income (expense), net in the Company's Consolidated Statements of Income.

Retained Earnings Not Available for Distribution

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

	February 29, 2016	August 31, 2015
Retained earnings not available for distribution	$ 5,717	$ 5,479

NOTE 6 – STOCK BASED COMPENSATION

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

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

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company adopted the 2013 Equity Incentive Award Plan (the "2013 Plan") for the benefit of its eligible employees, consultants and non-employee directors on January 22, 2013. The 2013 Plan provides for awards covering up to (1) 600,000 shares of common stock plus (2) the number of shares that remained available for issuance as of January 22, 2013 under three equity participation plans previously maintained by the Company. The number of shares reserved for issuance under the 2013 Plan increases during the term of the plan by the number of shares relating to awards outstanding under the 2013 Plan or certain prior plans that expire, or are forfeited, terminated, canceled or repurchased, or are settled in cash in lieu of shares. However, in no event will more than an aggregate of 1,233,897 shares of the Company's common stock be issued under the 2013 Plan.

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

	Shares authorized for issuance as of February 29, 2016 (including shares originally authorized for issuance under prior plans)	Shares available to grant	
		February 29, 2016	August 31, 2015
2013 Plan	944,905	649,965	847,876

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

	Three Months Ended		Six Months Ended	
	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
Options granted to directors	$ 8	$ 9	$ 33	$ 37
Restricted stock awards	1,976	1,454	3,677	2,703

Restricted stock units	494	321	868	600
Stock-based compensation expense	$ 2,478	$ 1,784	$ 4,578	$ 3,340

The following tables summarize other information related to stock-based compensation:

	As of	
	February 29, 2016	February 28, 2015
Remaining unrecognized compensation cost (in thousands)	$ 32,982	$ 18,045
Weighted average period of time over which this cost will be recognized (years)	5	6

	Six Months Ended	
	February 29, 2016	February 28, 2015
Excess tax benefit (deficiency) on stock-based compensation (in thousands)	558	1,457

The Company began issuing restricted stock awards in fiscal year 2006 and restricted stock units in fiscal year 2008. The restricted stock awards and units vest over a period of up to ten years, and the unvested portion of the award is forfeited if the employee or non-employee director leaves the Company before the vesting period is completed. Restricted stock awards and units activity for the period was as follows:

	Six Months Ended	
	February 29, 2016	February 28, 2015
Grants outstanding at beginning of period	366,021	488,416
Granted	225,151	16,911
Forfeited	(603)	(720)
Vested	(81,364)	(136,779)
Grants outstanding at end of period	509,205	367,828

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes the weighted average per share grant date fair value for restricted stock awards and units for the period:

	Six Months Ended	
Weighted Average Grant Date Fair Value	February 29, 2016	February 28, 2015
Restricted stock awards and units granted	$ 69.20	$ 89.85
Restricted stock awards and units vested	$ 84.68	$ 44.21
Restricted stock awards and units forfeited	$ 63.50	$ 40.40

The following table summarizes the total fair market value of restricted stock awards and units vested for the period (in thousands):

	Six Months Ended	
	February 29, 2016	February 28, 2015
Total fair market value of restricted stock awards and units vested	$ 5,975	$ 12,166

At the vesting dates of restricted stock awards, the Company repurchases shares at the prior day's closing price per share, with the funds used to pay the employees' minimum statutory tax withholding requirements. The Company expects to continue this practice going forward. The following table summarizes this activity during the period:

Six Months Ended

	February 29, 2016	February 28, 2015
Shares repurchased	26,637	49,931
Cost of repurchase of shares (in thousands)	$ 1,956	$ 4,441

The Company reissues treasury shares as part of its stock-based compensation programs. The following table summarizes the treasury shares reissued:

	Six Months Ended	
	February 29, 2016	February 28, 2015
Reissued treasury shares	—	—

The following table summarizes the stock options outstanding:

	February 29, 2016	August 31, 2015
Stock options outstanding	16,000	20,000

Due to the substantial shift from the use of stock options to restricted stock awards and units, the Company believes stock option activity is no longer significant and that any further disclosure on options is not necessary.

NOTE 7 – COMMITMENTS AND CONTINGENCIES

Legal Proceedings

From time to time, the Company and its subsidiaries are subject to legal proceedings, claims and litigation arising in the ordinary course of business and property ownership. The Company evaluates such matters on a case by case basis, and vigorously contests any such legal proceedings or claims which the Company believes are without merit. The Company establishes an accrual for legal proceedings if and when those matters reach a stage where they present loss contingencies that are both probable and reasonably estimable. In such cases, there may be a possible exposure to loss in excess of any amounts accrued. The Company monitors those matters for developments that would affect the likelihood of a loss and the accrued amount, if any, thereof, and adjusts the amount as appropriate. If the loss contingency at issue is not both probable and reasonably estimable, the

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Company does not establish an accrual, but will continue to monitor the matter for developments that will make the loss contingency both probable and reasonably estimable. If it is at least a reasonable possibility that a material loss will occur, the Company will provide disclosure regarding the contingency. The Company believes that the final disposition of the pending legal proceedings, claims and litigation will not have a material adverse effect on its financial position, results of operations or liquidity. It is possible, however, that the Company's future results of operations for a particular quarter or fiscal year could be impacted by changes in circumstances relating to such matters.

Taxes

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

The Company accrues an amount for its estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained.

In evaluating the exposure associated with various non-income tax filing positions, the Company accrues for probable and estimable exposures for non-income tax related tax contingencies. As of February 29, 2016 and August 31, 2015, the Company has recorded within other accrued expenses a total of $4.2 million and $4.1 million, respectively, for various non-income tax related tax contingencies.

While the Company believes the recorded liabilities are adequate, there are inherent limitations in projecting the outcome of litigation, in estimating probable additional income tax liability taking into account uncertain tax positions and in evaluating the probable additional tax associated with various non-income tax filing positions. As such, the Company is unable to make a reasonable estimate of the sensitivity to change of estimates affecting its recorded liabilities. As additional information becomes available, the Company assesses the potential liability and revises its estimates as appropriate.

During the first quarter of fiscal year 2015, the Company received provisional tax assessments with respect to deductibility and withholdings. These payments and assessments are discussed in further detail within Note 2, Income Taxes.

Other Commitments

The Company is committed under non-cancelable operating leases for the rental of facilities and land. Future minimum lease commitments for facilities under these leases with an initial term in excess of one year are as follows (in thousands):

Years ended February 28,	Open Locations(1)
2017	$ 10,031
2018	10,585
2019	10,454
2020	10,380
2021	9,346
Thereafter	90,515
Total	$ 141,311

(1) Operating lease obligations have been reduced by approximately $184,000 to reflect sub-lease income. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.

The Company is also committed to non-cancelable construction services obligations for various warehouse club developments and expansions. As of February 29, 2016 and August 31, 2015, these commitments were approximately $8.9 million and $12.3 million, respectively, for construction services not yet rendered.

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company has entered into a land purchase option agreement that has not been recorded as a commitment, for which the Company has recorded within the balance sheet approximately $200,000 within construction in process. The land purchase option agreement can be canceled at the sole option of the Company. The Company does not have a time table of when or if it will exercise this land purchase option, due to the uncertainty related to the completion of the Company's due diligence review. The Company's due diligence review includes evaluations of the legal status of the property, the zoning and permitting issues related to acquiring approval for the construction and operation of a warehouse club and any other issues related to the property itself that could render the property unsuitable or limit the property's economic viability as a warehouse club site. If the purchase option agreement is exercised, the cash use would be approximately $8.1 million.

See Note 10 - Unconsolidated Affiliates for a description of additional capital contributions that may be required in connection with joint ventures to develop commercial centers adjacent to PriceSmart warehouse clubs in Panama and Costa Rica.

The Company contracts for distribution center services in Mexico. The contract for this distribution center's services expires on December 31, 2017, with the applicable fees and rates to be reviewed at the beginning of each calendar year. Future minimum service commitments related to this contract through the end of the contract term are approximately $248,000.

NOTE 8 – DEBT

Short-term borrowings consist of lines of credit which are secured by certain assets of the Company and its subsidiaries and in some cases are guaranteed by the Company as summarized below (in thousands):

		Facilities Used			
	Total Amount of Facilities	Short-term Borrowings	Letters of Credit	Facilities Available	Weighted average interest rate
February 29, 2016	$ 67,491	$ —	$ 115	$ 67,376	— %

August 31, 2015	$ 57,691	$ 6,606	$ 728	$ 50,357	5.9 %

As of February 29, 2016 and August 31, 2015, the Company had approximately $40.0 million of short-term facilities in the U.S. that require compliance with certain quarterly financial covenants, which include debt service and leverage ratios. As of February 29, 2016 and August 31, 2015, the Company was in compliance with respect to these covenants. Each of the facilities expires annually and is normally renewed.

The following table provides the changes in long-term debt for the six months ended February 29, 2016:

(Amounts in thousands)	Current portion of long-term debt	Long-term debt (net of current portion)	Total
Balances as of August 31, 2015	$ 17,169	$ 73,365	$ 90,534 (1)
Proceeds from long-term debt incurred during the period:			
Costa Rica subsidiary	—	7,370	7,370
Repayments of long-term debt:			
Regularly scheduled loan payments	(396)	(6,351)	(6,747)
Reclassifications of long-term debt	(731)	731	—
Translation adjustments on foreign-currency debt of subsidiaries whose functional currency is not the U.S. dollar (2)	(24)	(68)	(92)
Balances as of February 29, 2016	$ 16,018	$ 75,047	$ 91,065 (3)

(1) The carrying amount on non-cash assets assigned as collateral for this total was $104.1 million. No cash assets were assigned as collateral for this total.
(2) These foreign currency translation adjustments are recorded within Other comprehensive income.
(3) The carrying amount on non-cash assets assigned as collateral for this total was $103.7 million. No cash assets were assigned as collateral for this total.

As of February 29, 2016, the Company had approximately $43.8 million of long-term loans in Trinidad, Panama, El Salvador, Honduras, Costa Rica and Colombia that require these subsidiaries to comply with certain annual or quarterly financial

covenants, which include debt service and leverage ratios. As of February 29, 2016, the Company was in compliance with all covenants or amended covenants.

As of August 31, 2015, the Company had approximately $47.4 million of long-term loans in Trinidad, Panama, El Salvador, Honduras, Costa Rica and Colombia that require these subsidiaries to comply with certain annual or quarterly financial covenants, which include debt service and leverage ratios. As of August 31, 2015, the Company was in compliance with all covenants or amended covenants.

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

Twelve months ended February 28,	Amount
2017	$ 15,466
2018	13,109
2019	12,655
2020 (1)	31,093
2021	10,222
Thereafter	3,865
Total (2)	$ 86,410

(1) The year 2020 is a leap year with the period ending February 29th.

(2) Amount includes the portion of the loans subject to cross-currency interest rate swaps, the Company has used the derivative obligation as of February 29, 2016, to disclose the future commitments in relations to the long-term debt and presented on the consolidated balance sheet.

NOTE 9 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

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

These derivative instruments (cash flow hedging instruments) are designated and qualify as cash flow hedges, with the effective portion of the gain or loss on the derivative reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction is determined to be ineffective. There were no such amounts recorded for ineffectiveness for the periods reported herein related to the interest rate or cross-currency interest rate swaps of long-term debt.

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

PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Cash Flow Hedges

As of February 29, 2016, all of the Company’s interest rate swap and cross-currency interest rate swap derivative financial instruments are designated and qualify as cash flow hedges. The Company formally documents the hedging relationships for its derivative instruments that qualify for hedge accounting.

The following table summarizes agreements for which the Company has recorded cash flow hedge accounting transactions during the six months ended February 29, 2016:

Subsidiary	Date Entered into	Derivative Financial Counter-party	Derivative Financial Instruments	Initial US$ Notional Amount	Bank US$ loan Held with	Floating Leg (swap counter-party)	Fixed Rate for PSMT Subsidiary	Settlement Dates
Costa Rica	28-Aug-15	Citibank, N.A. ("Citi")	Cross currency interest rate swap	$ 7,500,000	Citibank, N.A.	Variable rate 3-month Libor plus 2.50%	7.65 %	28th day of Aug November, Feb and May beginn on November 3 2015
Honduras	24-Mar-15	Citibank, N.A. ("Citi")	Cross currency interest rate swap	$ 8,500,000	Citibank, N.A.	Variable rate 3-month Libor plus 3.25%	10.75 %	24th day of Mar June, Septembe December begi on June 24, 201
El Salvador	16-Dec-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	$ 4,000,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.78 %	29th day of eac month beginnin December 29, 2
Colombia	10-Dec-14	Citibank, N.A. ("Citi")	Cross currency interest rate swap	$ 15,000,000	Citibank, N.A.	Variable rate 3-month Libor plus 2.8%	8.25 %	4th day of Marc June, Sept, Dec beginning on March 4, 2015
Panama	9-Dec-14	Bank of Nova Scotia	Interest rate swap	$ 10,000,000	Bank of Nova	Variable rate 30-day Libor	5.16 %	28th day of eac month beginnin

		("Scotiabank")			Scotia	plus 3.5%		December 29, 2
Honduras	23-Oct-14	Citibank, N.A. ("Citi")	Cross currency interest rate swap	$ 5,000,000	Citibank, N.A.	Variable rate 3-month Libor plus 3.5%	11.60 %	22nd day of Jan April, July, and October beginn on January 22,
Panama	1-Aug-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	$ 5,000,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.89 %	21st day of each month beginnin September 22,
Panama	22-May-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	$ 19,800,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.98 %	4th day of each month beginnin June 4, 2014
Panama	22-May-14	Bank of Nova Scotia ("Scotiabank")	Interest rate swap	$ 3,970,000	Bank of Nova Scotia	Variable rate 30-day Libor plus 3.5%	4.98 %	4th day of each month beginnin June 4, 2014

For the three and six-month period ended February 29, 2016 and February 28, 2015, the Company included the gain or loss on the hedged items (that is, variable-rate borrowings) in the same line item—interest expense—as the offsetting gain or loss on the related interest rate swaps as follows (in thousands):

Income Statement Classification	Interest expense on borrowings(1)	Cost of swaps (2)	Total
Interest expense for the three months ended February 29, 2016	$ 813	$ 471	$ 1,284
Interest expense for the three months ended February 28, 2015	$ 584	$ 714	$ 1,298
Interest expense for the six months ended February 29, 2016	$ 1,565	$ 1,018	$ 2,583
Interest expense for the six months ended February 28, 2015	$ 933	$ 1,226	$ 2,159

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

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

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PRICESMART, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Floating Rate Payer (Swap Counterparty)	February 29, 2016	August 31, 2015
Scotiabank	$ 34,858	$ 37,458
Citibank N.A.	32,237	34,287
Total	$ 67,095	$ 71,745

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

		February 29, 2016			August 31, 2015		
Derivatives designated as cash flow hedging instruments	Balance Sheet Location	Fair Value	Net Tax Effect	Net OCI	Fair Value	Net Tax Effect	Net OCI
Cross-currency interest rate swaps(1)	Other non-current assets	$ 4,735	$ (14)	$ (4,721)	$ 4,129	$ (1)	$ (4,128)
Interest rate swaps	Other long-term liabilities	(641)	170	471	(387)	98	289
Cross-currency interest rate swaps	Other long-term liabilities	(1,336)	401	935	(1,312)	482	830
Net fair value of derivatives designated as hedging instruments		$ 2,758	$ 557	$ (3,315)	$ 2,430	$ 579	$ (3,009)

(1) The tax effect of these swaps is largely offset by a valuation allowance.

The Company did not settle any derivatives during the six months ended February 29, 2016. The following table summarizes the derivatives that were settled during the twelve months ended August 31, 2015 (in thousands):

Date	Payment of Derivative Obligation	Foreign Exchange on Derivative Obligation	Recognize Settlement of Derivative Right net of Bank Fees	Swap Derivative (Gain)Loss	
23-Jul-15	$ 5,141	$ 2,929	$ (2,859)	$ 50	
31-Jul-15	1,343	670	(657)	11	
31-Jul-15	4,029	2,011	(1,971)	21	
6-Aug-15	4,944	3,181	(3,056)	70	
	$ 15,457	$ 8,791	$ (8,543)	$ 152	(1)

(1) Reclassified from accumulated other comprehensive income (loss) to other income (expense) for settlement of derivative instruments in the amount of $100,000, net of tax.

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Fair Value Instruments

The Company has entered into non-deliverable forward foreign-exchange contracts. These contracts are treated for accounting purposes as fair value contracts and do not qualify for derivative hedge accounting. The use of non-deliverable forward foreign-exchange contracts is intended to offset changes in cash flow attributable to currency exchange movements. These contracts are intended primarily to economically hedge exposure to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries whose functional currency is other than the U.S. dollar. The Company did not enter into any non-deliverable forward foreign exchange contracts during the six months ended February 29, 2016. The following table summarizes the non-deliverable forward foreign exchange contracts that the Company entered during the twelve months ended August 31, 2015:

Subsidiary	Dates entered into	Derivative Financial Counter-party	Derivative Financial Instrument	Notional Amount (in thousands)	Settlement Date	Effective Period of Forward
Costa Rica	31-Aug-15	Citibank, N.A.	Forward foreign exchange contracts	$ 3,750	August 30, 2016	August 31, 2015-August 30, 2016

For the three and six-month periods ended February 29, 2016 and February 28, 2015, the Company included in its consolidated statements of income the forward derivative gain or (loss) on the non-deliverable forward foreign-exchange contracts as follows (in thousands):