

PRICESMART INC  
Form 10-Q/A  
November 10, 2005

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q/A**  
**(Amendment No. 1)**

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

For the quarterly period ended November 30, 2004

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

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**PriceSmart, Inc.**

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(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**33-0628530**  
(I.R.S. Employer  
Identification No.)

**9740 Scranton Road**

**San Diego, California 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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The registrant had 25,765,846 shares of its common stock, par value \$.0001 per share, outstanding at October 31, 2005.

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*Explanatory Note*

This Amendment No. 1 to PriceSmart, Inc.'s (PriceSmart or the Company) Quarterly Report on Form 10-Q/A for the quarterly period ended November 30, 2004 includes unaudited restated consolidated financial statements at November 30, 2004 and August 31, 2004 (audited) and for the three months ended November 30, 2004 and 2003. The restatement affects the Company's consolidated financial statements at and for the three months ended November 30, 2004. No other financial statement information contained herein is affected by this restatement.

This Form 10-Q/A amends and restates Item 1 of Part I and Item 6 of Part II of the original Form 10-Q, and no other information included in the original Form 10-Q is amended hereby.

In connection with a routine review by the Securities and Exchange Commission of a registration statement filed by the Company on Form S-1, the Company has decided to restate the financial statements referenced above to record a \$20.6 million deemed dividend in the Company's first fiscal quarter of 2005 with respect to the Company's exchange of shares of common stock for the then-outstanding shares of Series A and Series B Preferred Stock. The exchange of shares of common stock for shares of Series B Preferred Stock occurred on October 29, 2004, and the exchange of shares of common stock for shares of Series A Preferred Stock occurred on November 23, 2004.

The restatement does not change the Company's previously reported revenue, operating income, net loss, cash, assets, liabilities or stockholders equity. However, the restatements do reflect a non-cash charge to deemed dividend on conversion of preferred stock on the Company's consolidated statement of operations of \$20.6 million, with a corresponding increase in the reported net loss attributable to common stockholders. The amount of the charge is equal to the difference of the value at the time of exchange of the shares of common stock exchanged for the preferred stock minus the value of the shares that the holders of the preferred stock otherwise would have had the right to receive upon conversion of the preferred stock. The Company's restated consolidated balance sheet records this charge as an increase in accumulated deficit with a corresponding increase in additional paid in capital, resulting in no change to the Company's total stockholders' equity.

The exchange of the shares of common stock for shares of Series A and Series B Preferred Stock referred to in the preceding paragraph was part of a broad financing plan announced by the Company on September 3, 2004. Prior to that announcement, a Special Committee of the Company's Board of Directors, comprised of directors who were not officers or employees of the Company and who were not affiliated with the holders of Series A or the Series B Preferred Stock, considered and approved the exchange and the other elements of the financing plan. The financing plan was described in detail in the Company's Current Report on Form 8-K filed September 3, 2004, the October 5, 2004 definitive proxy statement for the Company's October 29, 2004 special meeting of stockholders and the Company's Annual Report on Form 10-K for the year ended August 31, 2004. The financing plan was approved by the Company's stockholders on October 29, 2004.

In connection with its consideration of the financing plan, the Special Committee retained the services of a financial advisor, American Appraisal Associates, Inc. (American Appraisal). American Appraisal delivered a written opinion to the Special Committee as to the fairness, from a financial point of view, to the Company's unaffiliated holders of common stock of the proposed financing plan. As part of its analysis, American Appraisal established values for the outstanding shares of Series A and Series B Preferred Stock.

The Company did not record any charge to net loss attributable to common stockholders in connection with the exchange in the fiscal quarter ending November 30, 2004 because the aggregate value of the shares of common stock issued in the exchange were within the range of value attributed to the Series A and Series B Preferred Stock by American Appraisal. As a result of a further review of the accounting standard applicable to a transaction of this nature (Emerging Issues Task Force, Topic D-42), the Company has determined that it is necessary to report a deemed dividend with respect to these exchanges of common stock for preferred stock. The Audit Committee of the Company's Board of Directors has reviewed the matter with management and with the Company's independent registered public accounting firm. In addition, the Special Committee, having received a

supplemental letter from American Appraisal confirming that the change in accounting treatment does not affect its original analysis and opinion, has reaffirmed its conclusion that the financing plan, including the exchanges of common stock for the preferred stock was advisable to the Company's common stockholders.

As a result of the foregoing, the Company restated its financial statements and amended its Quarterly Reports on Forms 10-Q for the quarterly periods ended November 30, 2004, February 28, 2005 and May 31, 2005.

## PRICESMART, INC.

## CONSOLIDATED BALANCE SHEETS

(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

	November 30, 2004	August 31, 2004
	(Unaudited)	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 12,705	\$ 34,410
Short-term restricted cash	7,287	7,255
Receivables, net of allowance for doubtful accounts of \$2,647 and \$1,550, respectively	1,662	2,196
Merchandise inventories	86,637	62,820
Prepaid expenses and other current assets	10,888	10,185
	<u>119,179</u>	<u>116,866</u>
Total current assets	119,179	116,866
Long-term restricted cash	22,040	28,422
Property and equipment, net	176,083	173,420
Goodwill	23,071	23,071
Deferred tax asset	15,718	16,009
Other assets	7,632	7,650
Long-term receivables from unconsolidated affiliate	1,435	1,316
Investment in unconsolidated affiliate	8,794	9,254
	<u>373,952</u>	<u>376,008</u>
Total Assets	\$ 373,952	\$ 376,008
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Short-term borrowings	\$ 13,901	\$ 13,412
Accounts payable	69,726	56,148
Accounts payable to and advances received from related party	3,012	20,273
Accrued salaries and benefits	4,802	4,496
Deferred membership income	4,671	4,173
Income taxes payable	1,908	747
Deferred tax liability	584	592
Other accrued expenses	9,435	15,972
Long-term debt, current portion	15,433	16,503
	<u>123,472</u>	<u>132,316</u>
Total current liabilities	123,472	132,316
Deferred rent	1,373	1,260
Accrued closure costs, net of current portion	3,955	3,932
Long-term debt, related party		25,000
Long-term debt, net of current portion	64,458	82,138
	<u>193,258</u>	<u>244,646</u>
Total liabilities	193,258	244,646
Minority interest	3,570	3,483
Commitments and contingencies		
Stockholders Equity:		
Preferred stock, \$.0001 par value (stated at cost), 2,000,000 shares authorized;		
Series A convertible preferred stock 20,000 shares designated, 0 and 20,000 shares issued and outstanding, respectively (liquidation preference of \$0 and \$21,867, respectively)		19,914
Series B convertible preferred stock 30,000 shares designated, 0 and 22,000 shares issued and outstanding, respectively (liquidation preference of \$0 and \$24,014, respectively)		21,975
Common stock, \$.0001 par value, 45,000,000 shares authorized; 17,961,452 and 7,775,655 shares issued, respectively; and 17,525,607 and 7,339,810 shares outstanding (net of treasury shares), respectively	2	1
Additional paid-in capital	283,221	170,255

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Tax benefit from exercise of stock options	3,379	3,379
Notes receivable from stockholders	(30)	(33)
Deferred compensation	(1,712)	(1,932)
Accumulated other comprehensive loss	(17,199)	(18,314)
Accumulated deficit	(81,073)	(57,902)
Less: treasury stock at cost; 435,845 shares	(9,464)	(9,464)
	<u>          </u>	<u>          </u>
Total stockholders' equity	177,124	127,879
	<u>          </u>	<u>          </u>
Total Liabilities and Stockholders' Equity	\$ 373,952	\$ 376,008
	<u>          </u>	<u>          </u>

See accompanying notes.

## PRICESMART, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

	Three Months Ended November 30,	
	2004	2003
Revenues:		
Sales:		
Net warehouse club	\$ 153,026	\$ 143,741
Export	233	505
Membership income	2,362	2,113
Other income	1,100	1,600
Total revenues	156,721	147,959
Operating expenses:		
Cost of goods sold:		
Net warehouse club	129,522	125,623
Export	228	514
Selling, general and administrative:		
Warehouse club operations	19,728	20,423
General and administrative	5,092	5,166
Preopening expenses		10
Closure costs	367	220
Total operating expenses	154,937	151,956
Operating income (loss)	1,784	(3,997)
Other income (expense):		
Interest income	596	636
Interest expense	(2,926)	(2,849)
Other expense, net	(119)	(91)
Total other expense	(2,449)	(2,304)
Loss before (provision) benefit for income taxes, losses of unconsolidated affiliate and minority interest	(665)	(6,301)
(Provision) benefit for income taxes	(705)	52
Losses of unconsolidated affiliate	(454)	(404)
Minority interest	(52)	512
Net loss	(1,876)	(6,141)
Preferred dividends	(648)	(840)
Deemed dividend on conversion of preferred stock	(20,647)	
Net loss attributable to common stockholders	\$ (23,171)	\$ (6,981)
Loss per share common stockholders:		
Basic	\$ (2.25)	\$ (0.99)

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Diluted	\$ (2.25)	\$ (0.99)
Shares used in per share computation:		
Basic	10,311	7,079
Diluted	10,311	7,079

See accompanying notes.



## PRICESMART, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED AMOUNTS IN THOUSANDS)

	Three Months Ended November 30,	
	2004	2003
<b>OPERATING ACTIVITIES:</b>		
Net loss	\$ (1,876)	\$ (6,141)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,406	3,423
Allowance for doubtful accounts	1,097	74
Closure costs	367	220
Mark to market of stockholder note receivable	3	
Deferred income taxes	283	(258)
Minority interest	52	(512)
Equity in losses of unconsolidated affiliate	454	404
Compensation expense recognized for stock options	233	134
Cancellation of note receivable from stockholder		114
Change in operating assets and liabilities:		
Change in accounts receivable, prepaids, other current assets, accrued salaries, deferred membership and other accruals	(1,819)	2,183
Merchandise inventory	(23,817)	(458)
Accounts payable and accounts payable to and advances from related party	16,591	(816)
<b>Net cash flows used in operating activities</b>	<b>(5,026)</b>	<b>(1,633)</b>
<b>INVESTING ACTIVITIES:</b>		
Additions to property and equipment	(4,896)	(2,014)
<b>Net cash flows used in investing activities</b>	<b>(4,896)</b>	<b>(2,014)</b>
<b>FINANCING ACTIVITIES:</b>		
Proceeds from bank borrowings	44,151	23,906
Repayment of bank borrowings	(62,412)	(23,037)
Restricted cash	6,350	(24)
Issuance of common stock		5,000
Proceeds from exercise of stock options	5	
Issuance costs of common stock	(212)	
Issuance costs of Series B Preferred stock		(8)
Payment on note receivable from stockholder		10
<b>Net cash flows (used in) provided by financing activities</b>	<b>(12,118)</b>	<b>5,847</b>
Effect of exchange rate changes on cash and cash equivalents	335	(1,103)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(21,705)</b>	<b>1,097</b>
Cash and cash equivalents at beginning of period	34,410	11,239
<b>Cash and cash equivalents at end of period</b>	<b>\$ 12,705</b>	<b>\$ 12,336</b>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the period for:		
Interest, net of amounts capitalized	\$ 2,250	\$ 2,642
Income taxes	\$ 576	\$ 789
Supplemental disclosure of noncash financing activities related to the Financial Program:		
Issuance of common stock for:		
Series A Preferred Stock and accrued dividend	\$ 22,231	

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Series B Preferred Stock	\$ 22,000
Bridge loan and accrued interest	\$ 25,318
Advance payment on real estate and accrued interest	\$ 5,192
Purchase order financing and accrued interest	\$ 15,586
Issuance costs on preferred stock converted to Additional Paid-in Capital	\$ (111)
Accrued dividends on Series B Preferred Stock converted to Additional Paid-in Capital	\$ 2,298
Deemed dividend on conversion of preferred stock	\$ 20,647

See accompanying notes.

## PRICESMART, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

FOR THE THREE MONTHS ENDED NOVEMBER 30, 2004

(UNAUDITED AMOUNTS IN THOUSANDS)

	Preferred Stock Series A & Series B		Common Stock		Tax Benefit from Exercise of Notes Receivable from Deferred Compensation			Accumulated Other Comprehensive Loss		Less: Treasury Stock Accumulated		Total Stockholders Equity	
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Stock Options	Stockholders Compensation	Loss	Deficit	Shares	Amount		
Balance at August 31, 2004	42	\$ 41,889	7,776	\$ 1	\$ 170,255	\$ 3,379	\$ (33)	\$ (1,932)	\$ (18,314)	\$ (57,902)	436	\$ (9,464)	\$ 127,879
Dividends on preferred stock										(648)			(648)
Deemed dividend on conversion of preferred stock					20,647					(20,647)			
Financial Program, conversion to common stock	(42)	(41,889)	10,184	1	92,301								50,413
Exercise of stock options			1		5								5
Mark to market of employee restricted stock							3						3
Common stock issued and stock compensation expense					13			(13)					
Amortization of deferred compensation								233					233
Net loss										(1,876)			(1,876)
Translation adjustment									1,115				1,115
Comprehensive Loss													(761)
Balance at November 30, 2004		\$	17,961	\$ 2	\$ 283,221	\$ 3,379	\$ (30)	\$ (1,712)	\$ (17,199)	\$ (81,073)	436	\$ (9,464)	\$ 177,124

See accompanying notes.

**PRICESMART, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**November 30, 2004**

**NOTE 1 COMPANY OVERVIEW AND BASIS OF PRESENTATION**

PriceSmart, Inc. s ( PriceSmart or the Company ) business consists primarily of international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. As of November 30, 2004, the Company had 26 consolidated warehouse clubs in operation in 12 countries and one U.S. territory (four each in Panama and the Philippines, three in Costa Rica, two each in Dominican Republic, El Salvador, Guatemala, Honduras and Trinidad and one each in Aruba, Barbados, Jamaica, Nicaragua and the United States Virgin Islands), of which the Company owns at least a majority interest. The Company also had three warehouse clubs in operation in Mexico as part of a 50/50 joint venture with Grupo Gigante, S.A. de C.V. There also were 12 warehouse clubs in operation (11 in China and one in Saipan, Micronesia) licensed to and operated by local business people as of November 30, 2004. Subsequent to the end of the first quarter of 2005, the company terminated the license agreement with its China licensee, and recorded no licensing revenue in the quarter. The Company principally operates in four segments based on geographic area.

**Basis of Presentation** The consolidated financial statements have been prepared on a going concern basis. The Company has an accumulated deficit of \$81.1 million and a working capital deficit of \$4.3 million as of November 30, 2004. For the quarter ended November 30, 2004, the Company had a net loss attributable to common stockholders of \$23.2 million and used cash in operating activities of \$5.0 million. At November 30, 2004, the Company was not in compliance with certain maintenance covenants related to certain long-term debt arrangements. The Company has obtained or requested, but not yet received, all necessary waivers for covenant violations as of August 31, 2004, and November 30, 2004. The Company s ability to fund its operations and service debt during fiscal 2005 has been improved following the implementation of the Financial Program, as described in Note 6 Financial Program. Management believes that its existing working capital, together with the Financial Program mentioned above, is sufficient to fund its operations through at least August 31, 2005.

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Principles of Consolidation** The consolidated interim financial statements of the Company included herein include the assets, liabilities and results of operations of the Company's majority and wholly owned subsidiaries as listed below. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated interim financial statements have been prepared by the Company without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"), and reflect all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary to fairly present the financial position, results of operations, and cash flows for the interim period presented. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such SEC rules and regulations. Management believes that the disclosures made are adequate to make the information presented not misleading. The results for interim periods are not necessarily indicative of the results for the full year. The interim financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Form 10-K for the year ended August 31, 2004. The table below shows the Company's percentage ownership of, and basis of presentation for each subsidiary as of November 30, 2004.

	<u>Ownership</u>	<u>Basis of Presentation</u>
PriceSmart Aruba	90.0%	Consolidated
PriceSmart Barbados	100.0%	Consolidated
PSMT Caribe, Inc.:		
Costa Rica	100.0%	Consolidated
Dominican Republic	100.0%	Consolidated
El Salvador	100.0%	Consolidated
Honduras	100.0%	Consolidated
PriceSmart Guam	100.0%	Consolidated
PriceSmart Guatemala	66.0%	Consolidated
PriceSmart Jamaica	67.5%	Consolidated
PriceSmart Mexico	50.0%	Equity
PriceSmart Nicaragua	51.0%	Consolidated
PriceSmart Panama	100.0%	Consolidated
PriceSmart Philippines	52.0%	Consolidated
PriceSmart Trinidad	90.0%	Consolidated
PriceSmart U.S. Virgin Islands	100.0%	Consolidated
Ventures Services, Inc.	100.0%	Consolidated

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

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

**Restricted Cash** Short-term restricted cash primarily represents time deposits that are pledged as collateral for the Company's revolving line of credit and long-term restricted cash represents time deposits that are pledged as collateral for the Company's long-term debt.

**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, which occur primarily in the second

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and fourth fiscal quarters. In addition, the Company may be required to take markdowns below the carrying cost of certain inventory to expedite the sale of such merchandise.

**Allowance for Bad Debt** Credit is extended to a portion of members as part of the Company's wholesale business and to third-party wholesalers for direct sales. The Company maintains an allowance for doubtful accounts based on assessments as to the collectibility of specific customer accounts, the aging of accounts receivable, and general economic conditions. As of November 30, 2004, the Company had a total of approximately \$645,000 in net receivables due from a minority interest shareholder's importation and exportation businesses, which is included in accounts receivable on the consolidated financial statements. The Company previously utilized the importation and exportation businesses of one of its minority shareholders in the Philippines for the movement of merchandise inventories both to and from the Asian regions to its warehouse clubs operating in Asia. If the credit worthiness of a specific customer or the minority interest shareholder deteriorates, the Company's estimates could change and it could have a material impact on the Company's reported results.

**Property and Equipment** Property and equipment are stated at cost. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets. The useful life of fixtures and equipment ranges from 3 to 15 years and that of 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 as management believes it is reasonably assured that the renewal option in the underlying lease will be exercised.

**Goodwill** Goodwill, net of accumulated amortization, resulting from certain business combinations totaled \$23,071 at November 30, 2004 and August 31, 2004. The Company follows Statement of Financial Accounting Standards No. 142, Accounting for Goodwill and Other Intangibles, which specifies that goodwill and some intangible assets should no longer be amortized, but instead will be subject to periodic impairment testing. Accordingly, the Company reviews previously reported goodwill for impairment on an annual basis or more frequently if circumstances dictate. No impairment of goodwill has been incurred to date.

**Revenue Recognition** The Company recognizes sales revenue when title passes to the customer. Membership fee income represents annual membership fees paid by the Company's warehouse members, which are recognized ratably over the 12-month term of the membership. The historical membership fee refunds have been minimal and, accordingly, no reserve has been established for membership refunds for the periods presented.

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

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

**Selling, General and Administrative** 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 are the payroll and related costs for the Company's regional purchasing and management centers.

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General and Administrative costs include the payroll and related operating costs for the Company's corporate operations located in California and Florida, including the cost of U.S. merchandise purchasing.



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

**Closure Costs** The Company records the costs of closing warehouse clubs as follows: severance costs are accrued when a termination and benefit plan is communicated to the employees; lease obligations are accrued by calculating the net present value of the minimum lease payments net of the fair market value of rental income that could be received for these properties from third parties; all other costs are expensed as incurred. During fiscal year 2004, the Company closed one warehouse club and three during fiscal year 2003.

**Foreign Currency Translation** In accordance with Statement of Financial Accounting Standards No. 52 Foreign Currency Translation, the assets and liabilities of the Company's foreign operations are primarily translated to U.S. dollars using the exchange rates at the balance sheet date and revenues and expenses are translated at average rates prevailing during the period. Related translation adjustments are recorded as a component of accumulated comprehensive loss.

**Stock-Based Compensation** As of November 30, 2004, the Company had four stock-based employee compensation plans. Prior to September 1, 2002, the Company accounted for those plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Effective September 1, 2002, the Company adopted the fair value recognition provisions of SFAS No. 123 ( SFAS 123 ), Accounting for Stock-Based Compensation, using the prospective method with guidance from SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, to all employee awards granted, modified, or settled after September 1, 2002. Awards under the Company's plans typically vest over five years and expire in six years. The cost related to stock-based employee compensation included in the determination of net income for the quarters ended November 30, 2004 and 2003 is less than that which would have been recognized if the fair value based method had been applied to all awards since the original effective date of SFAS 123.

The following table illustrates the effect on net loss and loss per share if the fair value based method had been applied to all outstanding and unvested awards each period (in thousands, except per share data):

	<b>Three Months Ended November 30,</b>	
	<b>2004</b>	<b>2003</b>
Net loss attributable to common stockholders, as reported	\$ (23,171)	\$ (6,981)
Add: Stock-based employee compensation expense included in reported net loss, net of related tax effects	235	134
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(613)	(637)
<b>Pro forma net loss attributable to common stockholders</b>	<b>\$ (23,549)</b>	<b>\$ (7,484)</b>
Loss per share:		
Basic-as reported	\$ (2.25)	\$ (0.99)
Basic-pro forma	\$ (2.28)	\$ (1.06)
Diluted-as reported	\$ (2.25)	\$ (0.99)
Diluted-pro forma	\$ (2.28)	\$ (1.06)

**Accounting Pronouncements** During December 2004, the Financial Accounting Standards Board ( FASB ) issued Statement No. 123R, Share-Based Payment ( SFAS 123R ), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. Stock-based payments include stock option grants. The Company grants options to purchase common stock to some of its employees and directors under various plans at prices equal to the market value of the stock on the dates the options were granted. SFAS 123R is effective for all interim or annual periods beginning after June 15, 2005. Early adoption is encouraged and retroactive application of the provisions of FAS 123R to the beginning of the fiscal year that



includes the effective date is permitted, but not required. The Company has not yet adopted this pronouncement and is currently evaluating the expected impact that the adoption of SFAS 123R will have on its consolidated financial position, results of operations and cash flows.

**Reclassifications** Certain amounts in the prior period consolidated financial statements have been reclassified to conform to current period presentation.

**NOTE 3 PROPERTY AND EQUIPMENT**

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

	November 30, 2004	August 31, 2004
Land	\$ 37,029	\$ 34,068
Building and improvements	126,181	125,621
Fixtures and equipment	69,083	67,003
Construction in progress	602	241
	<u>232,895</u>	<u>226,933</u>
Less: accumulated depreciation	(56,812)	(53,513)
Property and equipment, net	<u>\$ 176,083</u>	<u>\$ 173,420</u>

Building and improvements includes capitalized interest costs of \$1.6 million as of November 30, 2004 and August 31, 2004.

**NOTE 4 LOSS PER SHARE**

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

	Three Months Ended November 30,	
	2004	2003
Loss attributable to common stockholders	\$ (23,171)	\$ (6,981)
Determination of shares:		
Average common shares outstanding	10,311	7,079

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Assumed conversion of:

Stock options(1)		
Preferred stock(2)		
Warrants(3)		
	_____	_____
Diluted average common shares outstanding	10,311	7,079
Net loss attributable to common stockholders:		
Basic loss per share	\$ (2.25)	\$ (0.99)
Diluted loss per share	\$ (2.25)	\$ (0.99)

- 
- (1) Stock options representing 97,083 and 0 shares were excluded, due to their anti-dilutive effects for the three months ended November 30, 2004 and 2003, respectively.
  - (2) The preferred stock was converted to common stock in the first quarter of fiscal year 2005, as part of the Financial Program. As of November 30, 2003, the preferred stock outstanding was convertible into 1,685,822 shares of common stock.
  - (3) A warrant for the issuance of 400,000 shares of common stock was outstanding as of November 30, 2004, at an exercise price of \$7 per share. These shares were excluded due to their anti-dilutive effects.

**NOTE 5 CLOSURE COSTS**

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

A reconciliation of the movements in the changes and related liabilities derived from the closed warehouse clubs as of November 30, 2004 is as follows (in thousands):

	<u>Liability as of August 31, 2004</u>	<u>Charged to Expense</u>	<u>Non-cash Amounts</u>	<u>Cash paid</u>	<u>Liability as of November 30, 2004</u>
Lease obligations	\$ 5,226	154		(370)	\$ 5,010
Other associated costs	94	213	(26)	(157)	124
<b>Total</b>	<b>\$ 5,320</b>	<b>367</b>	<b>(26)</b>	<b>(527)</b>	<b>\$ 5,134</b>

**NOTE 6 FINANCIAL PROGRAM**

On September 3, 2004, the Company announced a plan to implement a series of transactions (the "Financial Program") that are intended to increase PriceSmart's earnings (or decrease its losses) by substantially reducing the Company's interest expenses and preferred dividend obligations. Additionally, the capital that has been and is expected to be received through the Financial Program is expected to help improve the Company's liquidity, which is expected to result in more attractive terms from vendors. The Financial Program was approved by the stockholders on October 29, 2004. The elements of the Financial Program and the status of each element are as follows:

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

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

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

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The issuance of up to 16,052,668 shares of Common Stock in connection with a rights offering pursuant to rights to be distributed to the holders of outstanding shares of Common Stock, and the issuance of up to 3,125,000 shares of Common Stock, at a price of \$8 per share, to the Price Group to ensure that the above-mentioned rights offering generates at least \$25.0 million in proceeds. The rights offering subscription period began on December 21, 2004. The initial \$7 per share rights period is expected to end on January 21, 2005.

The issuance of up to 2,223,104 shares of Common Stock to exchange Common Stock, valued for such purpose at a price of \$10 per share, to the holders of all of the shares of the Company's 8% Series A Cumulative Convertible Redeemable Preferred Stock, in exchange for all of the outstanding shares of the

Series A Preferred Stock at its initial stated value of \$20.0 million plus all accrued and unpaid dividends. This exchange was completed on November 23, 2004, resulting in the issuance of 2,223,104 shares of common stock.

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

Also on October 29, 2004, The Price Group LLC, other Price-related entities and the San Diego Foundation in connection with the private placement, current obligation exchange and Series B Preferred Stock exchange described above filed with the Securities and Exchange Commission an amended Schedule 13D disclosing that their group beneficially owns greater than 50% of the Company's outstanding shares of common stock. As a result, the Company is a controlled company within the meaning of Nasdaq Marketplace Rule 4350(c)(5). Depending upon the extent to which the rights offering is subscribed by the Company's stockholders, the Company may continue to be a controlled company following the completion of the rights offering.

In connection with the Financial Program described above, the Company and certain of its subsidiaries entered into the following agreements in the first fiscal quarter of 2005 with the International Finance Corporation (the "IFC"): (i) to grant the IFC a warrant to purchase 400,000 shares of the Company's common stock at a price of \$7 per share; (ii) the Company purchased a \$10.2 million loan extended to PriceSmart Philippines, Inc.; (iii) the Company obtained a waiver of certain IFC loan covenants regarding incurring additional debt, in order to borrow the \$25.0 million in the bridge loan mentioned above; (iv) \$5.2 million of restricted cash pledged as collateral to certain loans was released; (v) all pre-payment penalties were waived for all outstanding loans from the IFC; (vi) the net carrying costs was reduced on one loan, by eliminating the IFC's right to a percentage of the Company's earnings, before interest, taxes, depreciation and amortization. Additionally, in connection with the agreements with the IFC, the Price Group (a related party to the Company) granted a put option giving the right to the IFC to sell 300,000 shares of Common Stock to the Price Group at a price of \$12 per share between November 30, 2005 and November 30, 2006. All of the above elements were completed during the Company's first quarter of fiscal 2005 with the exception of item (i), which was agreed to in principal although no warrants were exercised pending a final written agreement related to the put option between the IFC and the Price Group.

Additionally, in connection with the Financial Program, the Company has recorded a non-cash charge to Deemed dividend on conversion of preferred stock on the Company's consolidated statement of operations of \$20.6 million, with a corresponding increase in the reported net loss attributable to common stockholders. The amount of the charge is equal to the difference of the value at the time of exchange of the shares of common stock exchanged for the preferred stock minus the value of the shares that the holders of the preferred stock otherwise would have had the right to receive upon conversion of the preferred stock. The Company's consolidated balance sheet records this charge as an increase in accumulated deficit with a corresponding increase in additional paid in capital, resulting in no change to the Company's total stockholders' equity.

The exchange of the shares of common stock for shares of Series A and Series B Preferred Stock referred to in the preceding paragraph was part of a broad financing plan announced by the Company on September 3, 2004. Prior to the announcement of the Financial Program, a Special Committee of the Company's Board of Directors, comprised of directors who were not officers or employees of the Company and who were not affiliated with the holders of Series A or the Series B Preferred Stock, considered and approved the exchange and the other elements of the financing plan.

In connection with its consideration of the financing plan, the Special Committee retained the services of a financial advisor, American Appraisal Associates, Inc. ("American Appraisal"). American Appraisal delivered a written opinion to the Special Committee as to the fairness, from a financial point of view, to the Company's unaffiliated holders of common stock of the proposed financing plan. As part of its analysis, American Appraisal established values for the outstanding shares of Series A and Series B Preferred Stock.

The Company did not record any charge to net loss attributable to common stockholders in connection with the exchange in the fiscal quarter ending November 30, 2004 because the aggregate value of the shares of common stock issued in the exchange were within the range of value attributed to the Series A and Series B Preferred Stock by American Appraisal. As a result of a further review of the accounting standard applicable to a transaction of this nature (Emerging Issues Task Force, Topic D-42), the Company has determined that it is necessary to report a deemed dividend with respect to these exchanges of common stock for preferred stock. The Audit Committee of the Company's Board of Directors has reviewed the matter with management and with the Company's independent registered public accounting firm. In addition, the Special Committee, having received a supplemental letter from American Appraisal confirming that the change in accounting treatment does not affect its original analysis and opinion, has reaffirmed its conclusion that the financing plan, including the exchanges of common stock for the preferred stock was advisable to the Company's common stockholders.

#### **NOTE 7 COMMITMENTS AND CONTINGENCIES**

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

Following the announcement of the restatement of its financial results for fiscal year 2002 and the first three quarters of fiscal 2003 in November 2003, the Company received notice of six class action lawsuits filed in the United States District Court, Southern District of California against it and certain of its former directors and officers purportedly brought on behalf of certain current and former holders of the Company's common stock, and a seventh class action lawsuit filed against it and certain of its former directors and officers purportedly on behalf of certain holders of the Company's Series A Preferred Stock and a class of common stock purchasers. These suits generally allege that the Company issued false and misleading statements during fiscal years 2002 and 2003 in violation of federal securities laws. All of the federal securities actions were consolidated by an order dated September 9, 2004, which also appointed a lead plaintiff on behalf of the proposed class of common stock purchasers. The lead plaintiff filed a consolidated complaint on November 29, 2004, and the Company will have until February 4, 2005 to move to dismiss or otherwise respond to the consolidated complaint.

On September 3, 2004, the Company entered into a Stipulation of Settlement with respect to the action brought on behalf of a purported sub-class of plaintiffs comprised of unaffiliated purchasers of the Company's Series A Preferred Stock. On November 8, 2004 the settlement was approved. Pursuant to the settlement, this action has been dismissed and the Court has entered an order releasing claims that were or could have been brought by the sub-class, arising out of or relating to the purchase or ownership of the Company's Series A Preferred Stock. As a term of the settlement, members of the Series A Preferred sub-class were offered the opportunity to exchange their shares of Series A Preferred Stock, together with accrued and unpaid dividends thereon, for shares of the Company's common stock valued for such purposes at a price of \$10.00 per share. All members of this sub-class accepted the offer and exchanged their shares. The Company paid attorney's fees and costs to counsel for the sub-class in the amount of \$325,000, which was covered by the Company's directors and officers insurance carrier.

If the Company chooses to settle the remaining consolidated class action lawsuit without going to trial, it may be required to pay the plaintiffs a substantial sum in the form of damages. Alternatively, if these remaining cases go to trial and the Company is ultimately adjudged to have violated federal securities laws, the Company may incur substantial losses as a result of an award of damages to the plaintiffs.

On September 3, 2004, the Company also entered into a Stipulation of Settlement for a stockholder derivative suit purportedly brought on the Company's own behalf in San Diego County Superior Court against its



current and former directors and officers, alleging among other things, breaches of fiduciary duty. The same complaint also alleged that various officers and directors violated California insider trading laws when they sold shares of the Company's stock in 2002 because of their alleged knowledge of the accounting issues that caused the restatement. In the Stipulation of Settlement, the parties agreed that the prosecution and pendency of the litigation was a factor in the Company's agreement to seek to implement the Financial Program announced by the Company on September 3, 2004. The Court approved the settlement and entered final judgment on November 12, 2004, which dismissed the lawsuit with prejudice and included a release for the benefit of defendants. As a term of the settlement, the Company has paid attorney's fees to plaintiff's counsel in the amount of \$325,000, which was covered by the Company's directors and officers insurance carrier.

The United States Securities and Exchange Commission has informed the Company that it is conducting an investigation into the circumstances surrounding the restatement.

The indemnification provisions contained in the Company's Certificate of Incorporation and indemnification agreements between the Company and its current and former directors and officers require the Company to indemnify its current and former directors and officers who are named as defendants against the allegations contained in these suits unless the Company determines that indemnification is unavailable because the applicable current or former director or officer failed to meet the applicable standard of conduct set forth in those documents. While the Company has directors and officers liability insurance (subject to a \$1.0 million retention and a 20% co-pay provision), the Company has been informed that its insurance carriers are reserving all of their rights and defenses under the policy (including the right to deny coverage) and it is otherwise uncertain whether the insurance will be sufficient to cover all damages that the Company may be required to pay. Further, regardless of coverage and the ultimate outcome of these suits, litigation of this type is expensive and will require that the Company devote substantial resources and management attention to defend these proceedings. Moreover, the mere presence of these lawsuits may materially harm the Company's business and reputation. The Company has and will continue to incur substantial legal and other professional service costs in connection with the stockholder lawsuits and responding to the inquiries of the SEC. The amount of any future costs in this respect cannot be determined at this time.

In July 2003, the Company's 34% minority interest shareholder in the Company's Guatemalan subsidiary (PriceSmart (Guatemala) S.A.) contended, among other things, that both the Company and the minority interest shareholder are currently entitled to receive a 15% annual return upon respective capital investments in the Guatemalan subsidiary. The Company has reviewed the claim and other pertinent information in relationship to the Guatemalan joint venture agreement, as amended, and does not concur with the minority shareholder's conclusion. The Guatemalan minority shareholder continues to assert a right to receive a 15% annual return on its capital investment. In addition, the minority shareholder has advised the Company that it believes that PriceSmart (Guatemala), S.A. has been inappropriately charged by the Company with regard to various fees, expenses and certain related matters. The Company responded that it disagrees with virtually all of these additional assertions, and the minority shareholder advised that it may commission an audit with regard to such matters. On December 13, 2004, the Company filed a Demand for Arbitration against the Guatemala minority shareholder under the UNCITRAL Rules as administered by the American Arbitration Association. By that Demand, the Company seeks a declaratory judgment that the Company has properly charged fees and expenses and that neither the Company nor the minority interest shareholder is entitled to receive a 15% annual return on capital investment. The Demand also requests a declaratory judgment with respect to certain matters relating to the operation and governance of PriceSmart (Guatemala), S.A.

In addition, the Company's two minority shareholders in the Philippines (which together comprise a 48% ownership interest in the Company's Philippine operations (PSMT Philippines, Inc.)) have taken the position that an impasse of the Board of Directors of PSMT Philippines, Inc. has been reached. These minority shareholders have therefore sought to invoke the buy-sell provisions of the parties' Shareholders' Agreement (pursuant to which one shareholder may offer to purchase the interest of the other shareholders (at an appraised value) at which point the offeree shareholder may make a counter offer and the process continues until an offer is

accepted). The Company contends, among other things, that pursuant to the terms of the Shareholders Agreement no impasse has been reached (and hence the buy-sell provisions do not become applicable). On December 23, 2004, the Company filed in the San Diego Superior Court a Complaint against William Go (a principal of one of the minority shareholders) and two companies affiliated with William Go, seeking to recover principal and interest due and owing to the Company of at least \$781,000, as well as an accounting with regard to sums paid by the Company to William Go and the affiliated companies, and related relief. Additionally, on December 29, 2004, William Go and the E-Class Corporation (which owns 38% of PSMT Philippines, Inc.) filed with the Trial Court in Pasig City, Manila, a Complaint against those Directors of PSMT Philippines, Inc. who are appointees of the Company. The Complaint contends that the Company inappropriately transferred funds of PSMT Philippines, Inc. to the Company or otherwise inappropriately charged expenses to PSMT Philippines, Inc. The Complaint seeks an accounting and damages, as well as a temporary restraining order and/or preliminary injunction, and the appointment of receiver/management committee. The Company intends to vigorously defend this action through defendants as and when they are duly served and believes that the claims are without merit. On January 11, 2005 plaintiffs application for a temporary restraining order was denied, and a hearing on plaintiffs application for a preliminary injunction was set for January 17, 2005.

The Company believes that the ultimate resolution of any such legal proceedings or claims will not have a material adverse effect on its business, financial condition, operating results, cash flow or liquidity. However, such matters are inherently unpredictable and it is possible that the ultimate outcome could have a material adverse effect on its business, financial condition, operating results, cash flow or liquidity in any particular period by the resolution of one or more of these contingencies.

#### **NOTE 8 SHORT-TERM BORROWINGS AND LONG-TERM DEBT**

As of November 30, 2004 and August 31, 2004, the Company, together with its majority or wholly-owned subsidiaries, had \$13.9 million and \$13.4 million, respectively, outstanding in short-term borrowings, at weighted-average interest rates of 8.3% and 8.9%, respectively, which are secured by certain assets of the Company and its subsidiaries and are guaranteed by the Company up to its respective ownership percentage. Each of the facilities expires during the year and is typically renewed. As of November 30, 2004 and August 31, 2004, the Company had approximately \$6.6 million and \$6.3 million available on these facilities, respectively.

Additionally, the Company has a bank credit agreement for up to \$7.5 million, which can be used as a line of credit or to issue letters of credit. As of November 30, 2004, letters of credit and lines of credit totaling \$6.5 million were outstanding under this facility, leaving availability under this facility of \$1.0 million.

As of November 30, 2004 and August 31, 2004, the Company, together with its majority or wholly-owned subsidiaries, had \$79.9 million and \$123.6 million, respectively, outstanding in long-term borrowings. The Company's long-term debt is collateralized by certain land, building, fixtures, equipment and shares of each respective subsidiary and guaranteed by the Company up to its respective ownership percentage, except for approximately \$24.7 million and \$28.4 million, as of November 30, 2004 and August 31, 2004, respectively, which is secured by collateral deposits included in restricted cash on the balance sheet and letters of credit. The carrying amount of the assets collateralized was \$77.7 million and \$105.2 million as of November 30, 2004 and August 31, 2004, respectively. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.

Under the terms of debt agreements to which the Company and/or one or more of its wholly owned or majority owned subsidiaries are parties, the Company must comply with specified financial maintenance covenants, which include among others, current ratio, debt service, interest coverage and leverage ratios. As of November 30, 2004, the Company was in compliance with all of these covenants, except for the following: (i) debt service ratio for a \$11.3 million note (with an outstanding balance of \$2.1 million at November 30, 2004), for which the Company has requested, but not yet received, a written waiver of its noncompliance for the quarters ending August 31, 2004 and November 30, 2004; (ii) interest cost/EBIT (earnings before interest and



taxes) ratio for a \$6.0 million note (with an outstanding balance of \$3.9 million at November 30, 2004), for which the Company has requested and received, a written waiver of its noncompliance for the quarters ending August 31, 2004 and November 30, 2004; (iii) debt to equity ratio for a \$7.0 million note (with an outstanding balance of \$3.9 million at November 30, 2004), for which the Company has requested, but not yet received, a written waiver of its noncompliance for the quarters ending August 31, 2004 and November 30, 2004; and (iv) debt service ratio for a \$3.5 million note (with an outstanding balance of \$1.0 million at November 30, 2004), for which the Company has requested, but not yet received, a written waiver of its noncompliance for the quarter ending November 30, 2004. For the waivers requested, but not yet received, the Company believes that the waivers will be approved and waived for the periods requested. Additionally, the Company has debt agreements, with an aggregate principal amount outstanding as of November 30, 2004 of \$26.5 million that, among other things, allow the lender to accelerate the indebtedness upon a default by the Company under other indebtedness and prohibit the Company from incurring additional indebtedness unless the Company is in compliance with specified financial ratios. As of November 30, 2004, the Company did not satisfy these ratios. As a result, the Company is prohibited from incurring additional indebtedness and would need to obtain a waiver from the lender as a condition to incurring additional indebtedness. If the Company is unsuccessful in obtaining the necessary waivers or fails to comply with these financial covenants in future periods, the lenders may elect to accelerate the indebtedness described above and foreclose on the collateral pledged to secure the indebtedness. The Company believes that, primarily as a result of the Financial Program, it has sufficient financial resources to pay-down any of the above obligations which have maintenance covenant noncompliance as of November 30, 2004. Accordingly, the aforementioned obligations are reflected in the accompanying balance sheet under the original contractual maturities.

#### **NOTE 9 RELATED-PARTY TRANSACTIONS**

*Relationships with the Price Family:* As of November 30, 2004 Sol Price beneficially owns approximately 47.0% of the outstanding Common Stock. Sol Price is the father of Robert E. Price, the Chairman of the Board and Interim Chief Executive Officer of the Company. Robert E. Price beneficially owns approximately 48.0% of the outstanding Common Stock, including shares that may be deemed to be beneficially owned by Sol Price. Sol Price and Robert E. Price together beneficially own approximately 54.4% of the outstanding Common Stock.

*Series A and Series B Preferred Stock.* In January 2002, entities affiliated with Sol Price, Robert E. Price, James F. Cahill, Murray L. Galinson and Jack McGrory, purchased an aggregate of 1,650 shares of the Company's Series A Preferred Stock for an aggregate purchase price of \$1,650,000. In July 2003, entities affiliated with Sol Price, Robert E. Price, James F. Cahill, Murray L. Galinson and Jack McGrory, purchased an aggregate of 22,000 shares of the Company's Series B Preferred Stock for an aggregate purchase price of \$22,000,000. In connection with the Financial Program that was approved by the stockholders on October 29, 2004, the 1,650 shares of Series A Preferred Stock were exchanged for 183,405 shares of the Company's common stock, and the 22,000 shares of the Series B Preferred Stock were exchanged for 2,200,000 shares of common stock.

*Relationships with the Price Group:* In February 2004, the Company entered into an agreement with the Price Group which provided the Company with up to \$10.0 million of purchase order financing. Directors Robert E. Price, James F. Cahill, Murray L. Galinson and Jack McGrory are managers of the Price Group and collectively own more than 80% of that entity. The agreement allowed the Price Group to place a lien on merchandise inventories in the United States as security for such financing. Interest accrued at a rate of 1% per month. In July 2004, this agreement was amended to increase the funds available from the Price Group by \$5.0 million (to a total of \$15.0 million) for purchase order financing. This additional funding was secured by the Company's pledge of shares of its wholly-owned Panamanian subsidiary, PriceSmart Real Estate Panama, S.A. On October 29, 2004 amounts owed under this agreement were converted into 1,948,227 shares of Common Stock as part of the Financial Program that was approved by the stockholders on October 29, 2004.

In May 2004, the Company entered into another agreement with the Price Group to sell the real estate and improvements owned by the Company in Santiago, Dominican Republic. The purchase price was to be the fair

market value of the property and improvements as determined by an independent appraiser. Under the terms of the agreement the Price Group made an initial payment of \$5.0 million, with the balance to be paid upon closing, and if the closing did not occur for any reason, the initial payment was to be returned to the Price Group, plus accrued interest at the rate of 8% per annum. The agreement was subject to several contingencies, including the right of each party to terminate the agreement after receipt of the final appraisal report, and the approval by the Board of the final terms of the agreement. This Agreement was to terminate on August 31, 2004. However, on August 30, 2004, this agreement was extended for an additional 90 days, until November 30, 2004. On October 29, 2004 amounts owed under this agreement were converted into 648,973 shares of Common Stock as part of the Financial Program that was approved by the stockholders on October 29, 2004.

In August 2004, the Company entered into a \$25.0 million bridge loan with The Price Group, LLC. This loan accrued interest at 8% per annum. On October 29, 2004 amounts owed under this agreement were converted into 3,164,726 shares of Common Stock as part of the Financial Program that was approved by the stockholders on October 29, 2004.

*Relationship with Price Legacy Corp:* Sol Price had beneficial ownership through the Price Group and various family and charitable trusts of approximately 28.0% of the common stock (the Price Legacy Common Stock) of Price Legacy, formerly known as Price Enterprises, Inc. (PEI). Robert E. Price beneficially owned approximately 25.5% of the Price Legacy Common Stock, including shares that may have been deemed to be beneficially owned by Sol Price, and served as the Chairman of the Board of PEI until November 1999. Collectively, Sol Price, Robert E. Price and parties affiliated with them, including the Price Group, beneficially owned an aggregate of approximately 37.6% of the Price Legacy Common Stock. James F. Cahill, Murray L. Galinson and Jack McGrory, directors of the Company, beneficially owned approximately 16.4%, 16.1% and 15.9%, respectively, of the Price Legacy Common Stock, including shares that may have been deemed to be beneficially owned by Sol Price and Robert E. Price. In addition, each was a director of Price Legacy and Jack McGrory served as Chairman, President and Chief Executive Officer of Price Legacy. On December 21, 2004, Price Legacy was acquired by PL Retail, LLC and the above mentioned persons ownership in Price Legacy or the surviving entity ceased.

On March 26, 2004, the Company moved into its new headquarters located in San Diego, CA. Prior to this move, the Company leased office space from Price Legacy to house its headquarters. In April 2004, the Company received \$500,000 from its then landlord, Price Legacy, as an incentive to terminate early the lease of its headquarters. For the quarters ended November 30, 2004 and 2003, the Company paid Price Legacy \$0 and \$87,000 in rent, respectively.

*Use of Private Plane:* From time to time members of the Company's management used a private plane owned in part by PFD Ivanhoe, Inc. (PFD Ivanhoe) to travel to business meetings in Central America and the Caribbean. The Price Group owns 100% of the stock of PFD Ivanhoe, and Sol Price and James F. Cahill are officers of PFD Ivanhoe. The Price Group's members include Sol Price, Robert E. Price, James F. Cahill, Murray Galinson and Jack McGrory. Prior to March 2003, when the Company used the plane, it reimbursed PFD Ivanhoe for a portion of a fixed management fee and additional expenses PFD Ivanhoe incurred based on the number of hours flown, and also reimbursed PFD Ivanhoe for direct charges associated with use of the plane, including landing fees, international fees and catering. Since March 2003, the Company reimburses PFD Ivanhoe based on the amounts the passengers would have paid if they had flown a commercial airline.

*Put Option Agreement:* On December 15, 2003, the Company entered into an agreement with the Sol and Helen Price Trust, a trust affiliated with Sol Price, giving the Company the right to sell all or a portion of specified real property to the Trust at any time on or prior to August 31, 2004 at a price equal to the Company's net book value for the respective properties and upon other commercially reasonable terms. The specified real property covers both the land and building at nine warehouse club locations. As of August 31, 2004, the net book value of this real property was approximately \$54.9 million with approximately \$29.9 million of encumbrances (including \$5.1 million received as an advance payment for one of these properties). Under the terms of the agreement, the

Company would have the option, but not the obligation, to lease back one or more warehouse club buildings at an annual lease rate equal to 9% of the selling price for the building and upon other commercially reasonable terms. On August 30, 2004, this agreement was extended for an additional 90 days. As a result of the Financial Program, the Company did not exercise its rights under this agreement or extend it further.

*Promissory Notes:* In August 1998, Brud E. Drachman, Thomas D. Martin and Edward Oats purchased 1,894, 10,000 and 1,180 shares of common stock, respectively, pursuant to the stock purchase feature of the 1998 Equity Participation Plan. These officers delivered to the Company promissory notes in the amounts of \$19,357, \$108,500 and \$12,803, respectively. In August 1998, the Gans Blackmar Stevens Profit Sharing Plan FBO Robert M. Gans purchased 8,750 shares of common stock pursuant to the stock purchase feature of the 1998 Plan and delivered to the Company a promissory note in the amount of \$94,937.50. In August 1998, William J. Naylon purchased 7,500 shares of common stock pursuant to the stock purchase feature of the 1998 Equity Participation Plan and delivered to the Company a promissory note in the amount of \$81,375. In April 2000, John Hildebrandt purchased 3,738 shares of common stock pursuant to the stock purchase feature of the 1998 Equity Participation Plan and delivered to the Company a promissory note in the amount of \$149,987. The promissory notes delivered by Messrs. Drachman, Martin, Naylon and Oats, and the Gans Blackmar Stevens Profit Sharing Plan initially were non-recourse notes, bore interest at a rate of 6% per annum and had terms of six years. These notes were amended in June 1999 to become recourse notes, bearing interest at a rate of 5.85%. Mr. Hildebrandt's note is also a recourse note, bearing interest at a rate of 5.85%, with a term of six years. In August 2004, upon the expiration of term of their respective promissory notes, Messrs. Drachman, Martin, Naylon, Oats and the Gans Blackmar Stevens Profit Sharing Plan FBO Robert M. Gans paid all remaining principal and interest due under the notes by delivering an aggregate of 22,195 shares of common stock valued at \$7.56 per share (the closing price of the common stock on August 6, 2004) and paid an aggregate of \$149,177 in cash. Messrs. Drachman, Martin, Naylon, Oats and Gans received cash bonuses in August 2004, the after-tax proceeds of which were equivalent to the cash portion of the repayments described above. The initial principal amount on Mr. Hildebrandt's promissory note remains outstanding, and is immediately due and payable upon the termination of Mr. Hildebrandt's employment for any reason.

*Relationships with Edgar Zurcher:* Edgar Zurcher has been a director of the Company since November 2000. Mr. Zurcher is a partner in a law firm that the Company utilizes in legal matters and incurred legal expenses of approximately \$20,000 during the first quarter of fiscal 2005. Mr. Zurcher is also a director of a company that owns 40% of Payless ShoeSource Holdings, Ltd., which rents retail space from the Company. The Company has recorded approximately \$186,000 in rental income for this space during the first quarter of fiscal 2005. Mr. Zurcher is also a director of Banco Promerica, from which the Company has recorded approximately \$47,000 of rental income for the first quarter of fiscal 2005 for space leased to it by the Company. The Company also received approximately \$154,000 in incentive fees on a co-branded credit card the Company has with Banco Promerica in the first quarter of fiscal year 2005. Mr. Zurcher is also Chairman of the Board of Banca Promerica (Costa Rica), which lent \$900,000 as part of a \$5.9 million syndicated loan to the Company in fiscal 2000, and repaid in October 2004. During fiscal 2001, the Company entered into a \$1.9 million short-term credit facility with Banco Promerica (El Salvador), of which the \$1.3 million is outstanding as of November 30, 2004.

*Relationships with Grupo Gigante, S.A. and Angel Losada M.:* Gigante beneficially owns approximately 9.5% of the outstanding Common Stock. In January 2002, the Company entered into a 50/50 joint venture with Gigante to construct and operate warehouse clubs in Mexico. In addition, Angel Losada M., one of the directors of the Company, is currently Chairman of the Board of Directors and Executive President of Gigante. Mr. Losada also owns 13.5% of the common stock of Gigante, and together with members of his family, owns an aggregate of 69.4% of the common stock of Gigante. In fiscal 2004, Gigante purchased an aggregate of approximately \$123,000 of products from PriceSmart Mexico, the 50/50 joint venture subsidiary in Mexico. During the third quarter of fiscal 2002, the Company's Mexico joint venture began negotiations to lease certain property from Gigante in Mexico City, upon which the joint venture may construct and operate a membership warehouse club. In October 2002, the joint venture entered into a memorandum of intent for the allocation of construction expenses in connection with the proposed lease.

In January 2002, Gigante purchased 15,000 shares of the Company's Series A Preferred Stock for an aggregate purchase price of \$15,000,000 pursuant to a Series A Preferred Stock and Warrant Purchase Agreement entered into on January 15, 2002 between the Company and Gigante. Gigante also received a warrant to purchase 200,000 shares of our common stock at an exercise price of \$37.50 per share, subject to customary anti-dilution adjustments. The warrant expired one year from the date of issuance. On November 23, 2004, the Company issued an aggregate of 1,667,333 shares of its common stock to Gigante in exchange for all of the outstanding shares of the Company's Series A Preferred Stock held by Gigante as part of the Financial Program.

*Relationship with PriceSmart Mexico:* The Company sells inventory to PriceSmart Mexico and charges it for salaries and other administrative services. Such transactions are in the ordinary course of business at negotiated prices comparable to those of transactions with other customers. For the first quarter of fiscal year 2005, export sales to PriceSmart Mexico were approximately \$128,000 and are included in total export sales of \$233,000, on the consolidated statements of operations. Under equity accounting, for export sales to PriceSmart Mexico, the Company's investment in unconsolidated affiliate has been reduced by the Company's portion of the unrealized profit from these sales. Salaries and other administrative services charged to PriceSmart Mexico for the first quarter of fiscal year 2005 were approximately \$11,000.

*Relationships with PSC, S.A.:* PSC, S.A. beneficially owns approximately 4.3% of the Company's common stock. In addition, Mr. Zurcher is a director and 9.1% stockholder of PSC, S.A. In August 2002, the Company entered into a joint venture agreement with PSC, S.A. to form a new subsidiary to construct and operate a warehouse club in Nicaragua. The Company owns a 51% interest and PSC, S.A. owns the outstanding 49% interest in the subsidiary. In connection with the joint venture, in September 2002, PSC, S.A. purchased 79,313 shares of Common Stock from the Company at a price of \$33.50 per share, which is equivalent to the Company's capital investment in the joint venture.

*Relationship with Philippines minority interest shareholder:* The Company formerly utilized the importation and exportation businesses of one of its minority shareholder in the Philippines for the movement of merchandise inventories both to and from the Asian regions to its warehouse clubs operating in Asia. As of November 30, 2004, the Company had a total of approximately \$645,000 in net receivables due from the minority interest shareholder's importation and exportation businesses, which is included in accounts receivable on the consolidated financial statements.

The Company believes that each of the related party transactions described above were on terms that the Company could have been obtained from unaffiliated third parties.

**NOTE 10 SEGMENT REPORTING**

The Company is principally engaged in international membership shopping warehouse clubs operating primarily in Central America, the Caribbean and Asia as of November 30, 2004 (see Note 1). The Company operates in four segments based on geographic area and measures performance based on operating income. Segment amounts are presented after converting to U.S. dollars and consolidating eliminations. Certain revenues and operating costs included in the United States segment have not been allocated, as it is impractical to do so. The Mexico joint venture is not segmented for the periods presented and is included in the United States segment. The Company's reportable segments are based on management responsibility.

	<u>United States Operations</u>	<u>Central American Operations</u>	<u>Caribbean Operations</u>	<u>Asian Operations</u>	<u>Total</u>
<b>Three Months Ended November 30, 2004</b>					
Total revenue	\$ 238	\$ 87,462	\$ 53,371	\$ 15,650	\$ 156,721
Operating income (loss)	(378)	2,169	579	(586)	1,784
Depreciation and amortization	159	1,747	943	557	3,406
Identifiable assets	57,282	161,302	103,326	52,042	373,952
<b>Three Months Ended November 30, 2003</b>					
Total revenue	\$ 954	\$ 82,883	\$ 45,321	\$ 18,801	\$ 147,959
Operating income (loss)	(1,873)	1,231	(1,799)	(1,556)	(3,997)
Depreciation and amortization	206	1,570	1,205	442	3,423
Identifiable assets	78,530	159,241	96,044	56,559	390,374
<b>Year Ended August 31, 2004</b>					
Total revenue	\$ 2,391	\$ 348,917	\$ 192,883	\$ 65,509	\$ 609,700
Operating income (loss)	(4,020)	4,282	(6,967)	(9,524)	(16,229)
Depreciation and amortization	1,007	6,457	4,834	2,137	14,435
Identifiable assets	91,876	147,259	92,470	44,403	376,008



**ITEM 6. EXHIBITS**

(a) *Exhibits:*

- 3.1(1) Amended and Restated Certificate of Incorporation of the Company.
- 3.2(2) Certificate of Amendment of Amended and Restated Certificate of Incorporation of the Company.
- 3.3(3) Certificate of Amendment of Amended and Restated Certificate of Incorporation of the Company.
- 10.1(4) Promissory Note between The Price Group, LLC and the Company dated November 3, 2004 for \$3.0 million.
- 10.2(5) Letter of Understanding among The Price Group, LLC, the Company, PSMT Caribe, PSMT Trinidad, PSMT Philippines and the IFC, dated September 15, 2004.
- 10.3(5) Assignment and Assumption Agreement between the Company and the IFC, dated September 15, 2004.
- 10.4(5) Amended and Restated C Loan Agreement among the Company, PSMT Caribe, PSMT Trinidad and the IFC, dated September 15, 2004.
- 10.5(5) Amendment No. 2 to the IFC Loan Agreement among the Company, PSMT Caribe, Inc., PSMT Trinidad and the IFC, dated September 15, 2004.
- 10.6(6) Common Stock Purchase Agreement by and among the Company and the Investors named therein, dated as of October 4, 2004.
- 10.7(6) Stockholder Voting Agreement by and among the Company and the Investors named therein, dated as of October 4, 2004.
- 10.8(4) Twelfth Amendment to Employment Agreement between the Company and Robert M. Gans, dated September 24, 2004.
- 10.9(6) Employment Agreement by and between the Company and Jose Luis Laparte, dated as of June 3, 2004.
- 10.10(6) First Amendment to Employment Agreement by and between the Company and Jose Luis Laparte, dated as of August 2, 2004.
- 31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1\* Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2\* Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* These certifications are being furnished solely to accompany this Report pursuant to 18 U.S.C. 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and are not to be incorporated by reference into any filing of PriceSmart, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.

- (1) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended August 31, 1997 filed with the Commission on November 26, 1997.

- (2) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended February 29, 2004 filed with the Commission on April 14, 2004.
- (3) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended August 31, 2004 filed with the Commission on November 24, 2004.
- (4) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended November 30, 2004 filed with the Commission on January 14, 2005.
- (5) Incorporated by reference to the Current Report on Form 8-K filed with the Commission on September 20, 2004.
- (6) Incorporated by reference to the Current Report on Form 8-K filed with the Commission on October 8, 2004.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PRICESMART, INC.

Date: November 10, 2005  
\_\_\_\_\_

/s/ ROBERT E. PRICE  
\_\_\_\_\_  
**Robert E. Price**

**Interim Chief Executive Officer**

Date: November 10, 2005  
\_\_\_\_\_

/s/ JOHN M. HEFFNER  
\_\_\_\_\_  
**John M. Heffner**

**Chief Financial Officer**