[PSMT] - PriceSmart, Inc., Q3 2019 Earnings Release Conference Call
Thursday, July 11, 2019, 12:00 Noon Eastern

Officers
Maarten Jager; EVP, CFO
Sherry Bahrambeygui; CEO

Analysts
Jon Braatz; Kansas City Capital
Ronald Bookbinder; IFS Securities
Rodrigo Echagaray; Scotiabank
Thomas Vester; LGM
Charlie Carter; Ceredex

Presentation

Operator: Good day everyone, and welcome to the PriceSmart, Incorporated, Earnings Release Conference Call for the Third Quarter of Fiscal Year 2019, the three- and nine-month period ending on May 31st, 2019. (Operator Instructions)

After remarks from our company representatives, Sherry Bahrambeygui, Chief Executive Office, and Maarten Jager, Executive Vice President and Chief Financial Officer, you will be given an opportunity to ask questions as time permits. (Operator Instructions)

As a reminder, this conference is being recorded today, Thursday, July 11th, 2019. A digital replay will be available through July 18th, 2019, following the conclusion of the call by dialing 1-877-344-7529 for domestic callers, or 1-412-317-0088 for international callers, and entering replay access code 10131782.

At this time, I would like to turn the conference over to Maarten Jager. Please proceed, sir.

Maarten Jager: Thank you, Chris. Thank you, and welcome to our earnings call for the third quarter of fiscal year 2019. We will be discussing the information that we provided in our earnings press release and our 10-Q, both of which we released yesterday afternoon, July 10th, 2019. You can find both the press release and the 10-Q filing on our website at www.pricesmart.com.

As a reminder, all statements made on this conference call other than statements of historical fact, are forward-looking statements concerning the company's anticipated future plans, revenues and related matters. All forward-looking statements are based on current expectations and assumptions as of today, July 11th, 2019, but are not limited to

statements containing the words expect, believe, will, may, should, estimate, and similar expressions. These statements are subject to risks and uncertainties that could cause actual results to differ materially, including the risks detailed in the company's Annual Report on Form 10-K for the fiscal year ended August 31st, 2018, as filed with the Securities and Exchange Commission on October 25th, 2018.

The company undertakes no obligation to update forward-looking statements made during this call.

Now I will turn it over to Sherry Bahrambeygui, PriceSmart's Chief Executive Officer.

Sherry Bahrambeygui: Thank you, Maarten. Good morning everyone, and thank you for joining us today. Since our last call, we've been quite busy with club openings, both of which are our new smaller format design. The first is PriceSmart Veraguas, Panama, which opened on May 1st. It's our first smaller format club, approximately 38,000 square feet of sales floor. And although it's still early, we're pleased with the reception of this club as indicated by strong membership sign-ups.

I'd like to mention some things about Club Veraguas. It's located in a more agricultural rural area, Santiago, Veraguas, Panama, about 120 miles or about three hours from our nearest clubs there. This club has been specifically built and merchandised with the local market characteristics in mind. We're watching it closely, because if it performs as we expect, we believe this broadens our opportunities for healthy growth in secondary locations within our existing markets.

The second club opening was just two weeks ago, I attended in Santo Domingo in the Dominican Republic. This smaller format club is different in the sense that it's in a densely populated urban setting. Recognizing the demographics there, we've emphasized fresh, organics, and prepared foods and more specialty items merchandised with a more updated look and feel. There are also additional modalities that we're testing there. In Club Bolivar, we're trying various newer initiatives to drive sales within a smaller footprint by exercising very strong SKU discipline and leveraging technology that supports our ability to use alternative and efficient means to get merchandise to our members at a good value. This club provides us with the opportunity to see how we can drive sales within a smaller footprint.

I also want to mention that we put real effort into green initiatives in practice with this club, including more biodegradable packaging, solar power, recycled materials for the steel superstructure, and use of indigenous materials in the construction.

Although it's only been two weeks, we're seeing higher-than-average penetration of food service sales, which we attribute to the central location and the updated offering, and we expect this to drive frequency and traffic to the club.

I have to acknowledge how impressed I was with our team that I saw firsthand in the days and nights before the opening, and how meticulous they were about addressing

every last detail to ensure that each of the Six Rights of Merchandising were being employed. It's really a beautiful club, and we're excited about its prospects in this urban setting.

We are also getting ready for the opening of two additional clubs. The next opening will be our new club in Panama City, Panama. This will be our seventh club in Panama, and will be followed by the opening of our fourth club in Guatemala, located in San Cristobal. Our goal is to open both of these clubs by the peak holiday shopping season.

During Q3, we also closed on a key property in a location that we've been very excited about in Cayala, Guatemala.

I'm very appreciative of our real estate operations, logistics, and buying teams who accelerated the pace and are working very hard to basically open four new clubs within a six- to seven-month period.

In addition to a lot of activity on the real estate front, we continue our work on the development of pricesmart.com. Our vision to create an omnichannel member experience that includes a comprehensive digital catalog of merchandise available to be picked up at or delivered from the club or a regional distribution center, as well as merchandise that's available for delivery directly from our vendors, and also we will include cross-border shipments. As we develop our omnichannel capabilities, we continue to improve upon our analytics to help us better understand our members, with a focus on improving their PriceSmart experience. This is no small task and requires promoting a culture that embraces the capabilities that come with digital transformation.

Turning to supply chain. Inventory flow has improved during Q3 and through June. Inventory levels are roughly flat relative to a year ago, and that's with an additional club and the build up for the Bolivar club. I personally observed the improvement firsthand when I recently visited four of our clubs in the Dominican. One of my early efforts was to focus on efficiency of our supply chain, and we're beginning to see results, especially with a reduction in out of stocks.

We continue to dedicate efforts to evaluate the most intelligent ways to effectively flow merchandise from our vendors and DCs to our clubs and ultimately to our members, taking into consideration various factors, changing dynamics such as China tariffs and ways to maximize the optionality and resources we're building with our regional distribution centers.

Regarding memberships, we are pursuing opportunities to build more on our business membership, and we're investing resources to strengthen the value and the services that we can provide our business members.

We continue to expand on ways to provide better value for our PriceSmart members. For example, we've rolled out optical services and merchandise in seven clubs in Costa Rica,

which has proven to be quite successful. And we currently plan to add another approximate 18 locations within the next fiscal year in several additional markets.

Overall, we're seeing traffic up in all countries, even Nicaragua, which continues to suffer from political instability, and Honduras where there have been massive protests against the government, and Costa Rica which has imposed new tax laws which imposed VAT on certain product, and that's had an impact of increasing prices. And also, there is an increase on personal income tax rates at certain levels expected to go into effect this month.

So now let me turn to our results with an overview of Q3. Total revenues were $788.6 million, an increase of 0.8% over the comparable prior year period. Revenues consisted of primarily warehouse sales of $755 million, $8.3 million in export sales, $13.1 million in membership income, and $12.1 million in other revenue and income.

Net merchandising sales were $755 million, an increase of 0.6% over the prior year period. Currency fluctuations had a negative 3.7% impact on net merchandise sales. Comparable net merchandise sales in our 40 clubs open more than 13 1/2 months, decreased by 0.8%, with currency fluctuations impacting comparable sales negatively by 3.8%.

As a reminder, we ended this quarter, Q3, with 42 warehouse clubs compared to 41 clubs at the end of the third quarter fiscal year 2018.

Net income for the third quarter of fiscal year 2019, was $14.1 million or $0.46 per share compared to $18.7 million or $0.61 per share in the comparable period last year. This year's results includes a $0.09 per share impact from a combination of our ongoing investments in the development of our omnichannel platform and technological capabilities, costs associated with the acquisition we made in March 2018, and the operations of the legacy business associated with that acquisition.

Turning now to sales by segment. The Central American segment, where we had 23 clubs at quarter end, had a 1.2% decrease in total merchandise sales and a 1.8% decrease in comparable sales. Sales were impacted by what we believe in general weakness in the economies in Costa Rica, Panama, Honduras, and Nicaragua, some of those things I described a little earlier. These countries contributed approximately 1.5% of the total comparable sales decrease. The impact of currency on total and comparable sales to the Central American segment were each negative 3%.

Regarding the Caribbean, the Caribbean segment, where we had 12 clubs at quarter end, had total merchandise sales growth of 6.5%, with comparable sales growth of 2.9%. Jamaica and Trinidad led the way in the segment reporting with strong same-store sales growth of approximately 12.6% and 2.9%, respectively, and contributed 70 positive basis points to overall comparable sales.

Aruba and USVI were also positive contributors, while same-store sales were adversely affected in the DR by the opening of the San Isidro store. The San Isidro store which is not included in same-store sales, cannibalized sales from other clubs that are included in the calculation, which had a negative impact on net comparable sales of approximately 50 basis points. The impact of currency on both total and comparable sales to the Caribbean segment was negative 1.1%.

And last, Colombia, where we had seven clubs at quarter end, had a 3.9% decrease year-over-year, with a comparable sales decline of 4.5%. The impact of currency on total and comparable sales in Colombia was significant. It was negative 13% and negative 13.3%, respectively.

In terms of merchandise category highlights, we saw sales increase in our overall U.S. foods and fresh foods. We saw strong growth in our seafood, deli, and meat departments. We had good U.S. dollar comp growth in categories including canned seafood, soda and beverages, pet supplies, tires, and small appliances. We were flat to slightly lower in local foods and nonfood.

With regard to membership, we finished the quarter with approximately 1.6 million accounts, which is a 2.4% increase fiscal year-to-date. Membership income was up by 2.2% during the quarter. The 12-month renewal rate at the end of May was consistent at 85%. In addition, the platinum program grew 45% year-over-year, and has now been rolled out in Panama, Costa Rica, the Dominican Republic, USVI, Honduras, Jamaica, and Barbados. Platinum memberships represented almost 3% of our total membership base. And as you can see, our membership base continues to grow. That's a good sign for our unique model, especially considering that we are weathering some headwinds in many of these markets.

Turning quickly to June sales, which were released this week. Net merchandise sales were $253.1 million, an increase of 3.9% versus a year ago. FX fluctuations negatively impacted merchandise sales by 3%. For the four weeks ended June 30, 2019, comparable net merchandise sales increased by 1.9%, with a negative FX impact of 3.1%.

In closing, we have confidence in our business model and we're encouraged by the loyalty of our members and the reception we're seeing in our new locations. With our discipline focused on the Six Rights and by continuing to challenge ourselves to operate more efficiently at every level of the company, we believe we'll be able to drive significant revenue growth from same-store sales over time. We also believe that by adding new sources of growth from new clubs and new formats in conjunction with our digital omnichannel capability, that we're strengthening our foundation to drive membership and shareholder value.

Once again, I want to especially recognize and thank our approximately 9,100 employees internationally, for their dedication and commitment to our company.

Thank you for your time. I'll now turn the call over to Maarten Jager, our Chief Financial Officer, who will go into further detail about our third quarter results.

Maarten Jager: Thank you, Sherry. Starting with margins. Merchandise margins for the period came in at 13.9% versus 14.6% a year ago. Total gross margins decreased to 16.1% from 16.6% a year ago, mainly due to lower net merchandise margins along with lower margins on nonmerchandise revenues of our legacy Aeropost business, which decreased the gross margin to total revenues ratio by approximately 10 basis points, offset by 30 basis points of margin increase due to the payment and reclassification of shared income generated from co-branded cards.

SG&A to total business was 13.3% versus 12.9% a year ago. Warehouse club and other operations expense increased by approximately 20 basis points due to the opening of the new Veraguas club in Panama. The remaining increase is attributable to pre-opening expenses for the two clubs that had already been open by the close of Q3 and for the two other clubs which will be opened after Q3.

Operating income was $22 million, 2.8% of total revenue, versus $28.4 million or 3.6% of total revenue a year ago. Operating income for the core warehouse club business decreased to $25.9 million versus $29.9 million a year ago, again largely due to the lower net merchandise margins as well as the higher pre-opening expenses for the four clubs in one calendar year.

Moving on to tax. For the quarter, the effective tax rate was 34.7%. The increase versus the 30.3% rate in the same quarter last year was driven largely by the loss of tax asset value incidental to U.S. tax reform, impacting us by 6.4%, partially offset by the adjustment of costs incurred to expand our omnichannel capabilities of 2.2%.

Consistent with our estimates in Q2, we currently expect the full year tax rate to be 36%. This is higher than our first three quarters, primarily due to timing of the effects from U.S. tax reform.

Recall from the last earnings call that Aeropost, the acquisition we made in March of 2018, consists of both a legacy business and our investment in the pricesmart.com digital platform, which we believe will drive member value in coordination with our warehouse clubs and distribution footprint.

The legacy Aeropost business adversely impacted net income by $1 million for the quarter. The investments into our digital platform during the past quarter adversely impacted net income by $1.8 million. And finally, as I've mentioned before, there are the acquisition-related accounting impacts, which adversely impacted net income by $0.1 million for the quarter. The total of these three buckets is $2.9 million of net income impact, or $0.09 per share.

Moving on to the balance sheet, which remains very strong. The company ended the quarter with cash and cash equivalents of $114 million, an increase of $17.1 million

during the first nine months of the year. During the first nine months, cash provided by operating activities was $113 million versus $90.8 million in the same quarter last year, for a favorable swing of $22.2 million. This was primarily due to improved working capital.

Net cash used in investing activities declined by $81.2 million, primarily due to the nonrecurring business acquisition purchase last year, in other words the Aeropost acquisition of $29 million, along with significantly fewer purchases of short-term investments.

Investing activities for this year were primarily associated with the construction of our four new warehouse clubs, again, Veraguas, Metropark, Bolivar, and San Cristobal. That's in Panama, the Dominican Republic, and Guatemala, respectively.

Net cash used in financing activities increased $9.1 million, primarily due to the regularly scheduled loan payments.

In summary, we've seen some headwinds in U.S. dollar-reported sales, which were largely impacted by a continuation of foreign currency devaluation. The fundamentals of our business, as evidenced by our membership counts and renewal rates, our constant currency sales overall, reinforce that we have a strong business model and significant growth opportunities. We will continue to focus on the Six Rights, driving same-store sales, delivering on our announced real estate pipeline, and launching and continuing to develop our digitally enabled omnichannel platform. Our balance sheet, liquidity, and cash flow remain strong, which provides a solid foundation for driving same-store sales and future growth that will benefit our members and shareholders alike.

Operator, we will now turn it over to Q&A.

Questions and Answers.

Operator: We will now begin the question-and-answer session. (Operator Instructions) Jon Braatz of Kansas City Capital.

Jon Braatz: Turning to gross margins a little bit. Merchandise margins came in at 13.9%. Or I should say warehouse margins came in at 13.9%. That was the lowest we've seen since May of 2016, or third quarter of 2016, when you had to reduce margins to move some merchandise.

Is this at sort of a new level of margins that we're looking at? Has there been a change in competitive conditions? I know you're trying to drive same-store sales. But is this something that we should be looking to see continue, a little bit of pressure on margins?

Sherry Bahrambeygui: In short, the answer is, that is not our expectation. We are focused on margin. We had clearly some competitive dynamics that we addressed. But

also, in focusing on improving our inventory flow, there were certain markdowns that took place that allowed us to improve on the flow and help drive sales.

But the short answer is, no, there is focus on margin and there is an expectation that we'll be able to increase margin going forward.

Maarten, do you want to add anything?

Maarten Jager: Thanks, Sherry. No, that's exactly right. We are focused on it, and we're expecting to improve on it. Let me just give you a little bit more color on it, some context.

We saw some of this margin erosion in all of our regions. So there are 70 basis points that you see in the numbers of reduction. About 10 of that came in Colombia, about 40 in Central America, and about 20 in the Caribbean. So that's the geographic breakdown.

If you were to look at it from different drivers, there's a bit of FX in there that impacted us. There's also, as Sherry mentioned, markdowns that we took to clear up our inventory, particularly, of course, in nonfoods. So we took some markdowns there. And the good news from that, and Sherry mentioned it earlier in her remarks, is that that's behind us. Our inventory is roughly flat year-over-year, at the end of May 31st. And that's with an additional club open and with the Bolivar club that, while it wasn't opened as of May 31st, was already receiving build-up inventory in anticipation of its opening.

And Sherry also mentioned that in visiting the DR, she saw that there was less and it was more open steel and things were flowing better.

So the other factor, there's some competitive pressure, but I would not say that that's the primary factor, particularly in one of our markets in the Caribbean, Jon.

So then stepping back, we are monitoring it. We are managing it. We've cleared up the inventory, that's clear. We're asking also some additional questions in terms of sourcing and working with our suppliers. We're looking at the mix of imported versus local and just making sure that we exercise pricing discipline. And all of this, of course, needs to be done with member value in mind and the competitive dynamics.

But in short, as Sherry summarized, this is not the new normal and we think we can improve upon it.

Sherry Bahrambeygui: Yes. We do have a strong focus, and we are looking market-by-market very specifically at all aspects, including the competitive landscapes, the cost of doing business. So there is a very concerted focus on making sure that margins are set appropriately with all of the relevant factors in mind and all within the discipline of delivering good value to our members. So there's a very disciplined approach we're taking to looking at margins going forward, and so I would not expect that you would see the same that you have in the last quarter.

Jon Braatz: Maarten, Sherry, if you were to maybe ex-out some of these in the quarter, some of these onetime items, you mentioned the markdowns and so on and so forth, is there any sense -- or can you give us a sense as to what those onetime items maybe amounted to in terms of reducing margin?

Maarten Jager: Let me try to help you in part. So we have mentioned markdowns in nonfoods and cleaning up some of the inventory. That contributed about 30 to 35 basis points, roughly, okay, of the 70 basis points, all right? But then the rest of it, I don't have at my fingertips. But I think [that will] give you a pretty good indication.

Jon Braatz: Okay. All right. I appreciate that. And then one final question. Sherry, you talked about the new location in Panama and using a lot more local merchandise. Compared to your other stores, what percentage of your merchandise in that store is locally derived? I'm curious as to sort of the relative difference between the big stores and this one?

Sherry Bahrambeygui: So I don't know that I said anything about local merchandise. And you're talking about the Veraguas club right now that is in more of an agricultural rural area, not (indiscernible).

Jon Braatz: Yes. Yes, exactly.

Sherry Bahrambeygui: No. I think the statement I made was that we were focused on meeting the member needs of that type of demographic, which is very distinct, for example, from the membership that we have in the Bolivar location, just by way of comparison. But with the type of agriculture that's out there and the products that they need in terms of machinery or tools . . .

Jon Braatz: Okay. Okay. I'm sorry. I misinterpreted what you had said.

Sherry Bahrambeygui: Yes.

Jon Braatz: When you look at a store such as this and if it is proved successful, how might that expand your location opportunities across your markets?

Sherry Bahrambeygui: Well, it's too early to tell. I mean to be perfectly honest, personally, I'm excited about the prospects, but it really is too early to tell. Because if it's something that we feel can perform at the levels that we're expecting Veraguas to perform, it really does open our minds up to other geographic areas, other towns that have not been the subject of our focus so much in the past, because the property is less expensive in these areas, the footprint can be a bit smaller. If we can tailor and meet the needs of our members in these locations, it does open doors. It opens doors for us to consider markets that really haven't been on our radar screen before. But I don't want to overstate it, because we really want to make sure that we're doing this right and it's

performing as expected. And based on those results, we're going to build on the positives. But I do see it as a potential opportunity for good growth.

Jon Braatz: Yes. All right. Thank you, Sherry.

Operator: Ronald Bookbinder: of IFS Securities.

Ronald Bookbinder: Thank you for the additional color on the merchandise gross margin. But why the lower gross margin on the Aeropost business versus last year?

Maarten Jager: Ron, I'm going to have to get back to you on that one.

Ronald Bookbinder: Okay. No problem.

Maarten Jager: Late this afternoon.

Ronald Bookbinder: Okay.

Sherry Bahrambeygui: And just to give you a piece of information, we've discussed the fact that earlier in this process as we're building our pricesmart.com, we are using the aeropost.com site to test certain things before we migrate over to pricesmart.com. So there has been some effort to drive some of the activity over to pricesmart.com once we've proven that something's working well. So what we're finding, frankly, Ronald, is that the activities of aeropost.com and PriceSmart are becoming a little bit more blurred, as it should, over time. So I don't think we've called out specifically that information. But Maarten can get back to you following that. But I just wanted to give you some background on what's happening.

Ronald Bookbinder: Okay. And in Colombia, right now, you're having just a tough FX situation down there. But what is the overall view of Colombia? It doesn't seem like you guys have opened a store there since Chia in September of 2016. With these new smaller format stores, could we see a ramping up in Colombia? And do you guys still have a real estate office in Bogota?

Sherry Bahrambeygui: We are active in pursuing real estate and looking for opportunities to grow in Colombia. We believe in that market. No doubt, the FX fluctuations, and the currency devaluation there has been a challenge for us. We're well received there, membership is strong. If you look in constant currency, our same-store sales comps are doing well. The issue for us right now is that we're trying to, one -- as you know, real estate is obviously a challenge there. But yes, with a small format, it opens up more opportunities for us to find more suitable locations.

And then a separate point I wanted to make was with regard to your comment on the effect of the currency. We are also looking for ways to be smarter about matching up some of our expenses for the company and with merchandise with the revenue that we generate through sales. So we're not being passive in terms of the Colombia FX effect.

We are looking to source more merchandise locally. Colombia is a very developed market. It's one where we can source exciting merchandise not only for that market, but expand exports into other markets. And we're looking for smart ways to be able to naturally hedge, if you will, some of the impact of the negative FX. So we are very, very committed to Colombia, not just in terms of expanding clubs, but cultivating resources that'll strengthen the company overall.

Ronald Bookbinder: Okay. And you guys have been performing actually, your core business has been performing actually very well if you back out the FX impact. And now you've got this exciting opportunity of the smaller stores going into new markets.

Given the lower valuation of your stock, I know you don't have a share repurchase program and your Q states that you don't expect to have one going forward, but given where the stock is, why wouldn't the board consider an authorization?

Sherry Bahrambeygui: Our first prior is to make this company as strong as it possibly can be. That's where all efforts are focused at this time. And beyond that, I really don't have any other comment on it, other than real estate, and that there's a potential for real estate there that we could explore.

Maarten Jager: I think a great question. We generate, as you know, a lot of operating cash flow from our business, and we continue to believe that we have a lot of growth opportunity ahead of us in a number of markets, which, of course, requires significant real estate investment. And so our first focus, in the broader context, our focus is to do same-store sales, is to grow in new markets with new real estate, is to invest in our supply chain to back it up, and it's to do omnichannel. And so our first port of call for the operating cash flow is to invest in our future growth.

Ronald Bookbinder: Okay. Great. Thank you for taking my questions, and good luck in the new quarter.

Sherry Bahrambeygui: Thank you.

Maarten Jager: I'll come back to you with a little bit more detail on the Aeropost margins. But there was a reclassification from G&A to COGS that started in the fourth quarter of 2018, which creates a bit of a comparability issue quarter-over-quarter. But I'll follow up with a more thorough answer.

Ronald Bookbinder: Would we expect that [to] continue in the future quarters?

Maarten Jager: Yes, the reclassification would continue to hit us. But as I said, I'll follow up with you. Thanks for those questions.

Ronald Bookbinder: Okay. Thank you.

Operator: Rodrigo Echagaray of Scotiabank.

Rodrigo Echagaray: Thanks for the call, Sherry and Maarten. I guess, two questions on my end. On the one hand, it sounds like the new formats are promising early stages, but sounds like that's the case. And so far, I think we've touched on the opportunity of smaller cities, maybe more urban areas. But what about new countries? Do you guys think that is also something that should be more likely as a result of these new formats?

Sherry Bahrambeygui: Yes. Not just because of the new formats, but because of the digital capabilities that allow us to potentially test new markets. So as part of our ongoing efforts generally, we are evaluating opportunities that exist in additional countries. I really don't have anything more on that at this point.

Rodrigo Echagaray: And is that related to the analytics that you guys now have as a result of Aeropost and the online initiatives, that you feel like that data could potentially help you find new countries better? Would that be a correct assessment?

Sherry Bahrambeygui: It's not so much as the analytics. I'm sure analytics can play into this. But it's also the ability, potentially down the road, through omnichannel and the technological capabilities that support omnichannel that would allow us to test different markets and the reception in different markets of the PriceSmart brand or basically the PriceSmart model and the merchandise that we provide.

Rodrigo Echagaray: Okay. Got it. And if I take us back, there's a lot of progress on working capital, there's new formats, there seems to be a bit of a slight pickup in store openings. And so what would you say, Sherry, is your top priority for say next fiscal year and maybe midterm? I mean, there's a lot of things happening. It sounds like some of these are very promising initiatives. But what would you say would be your top priority for next year?

Sherry Bahrambeygui: We continue to put substantial efforts in on the real estate side hand-in-hand with the development of our digital transformation. And we see that interrelationship. We want to really strengthen that interrelationship between the digital capabilities with the brick-and-mortar, to be able to maximize our opportunity to flow merchandise in the most cost-effective manner to the members. So it's holistic and it's all interrelated.

Rodrigo Echagaray: Got it.

Sherry Bahrambeygui: We're also focused on building our people, investing in our people, and strengthening further our management team so that we have the capabilities and the bandwidth to be able to continue to grow without being distracted or taking away from what we're doing very well.

Rodrigo Echagaray: Okay. And maybe, Maarten, on the same-store sales of the most recent announcement, what else will you say are some of the takeaways? I mean there was an uptick on the number. Anything interesting that maybe you can touch on in terms

of some of the regions or trends relative to the previous months? I mean I think the FX, obviously, probably is still impacting negatively. But other than that, anything else that you're seeing on the latest [print] that might be worth touching on?

Maarten Jager: Rodrigo, are you referring to the June sales release or are you referring to . . .

Rodrigo Echagaray: Yes.

Maarten Jager: Okay. Well, I think the June sales release speaks for itself. It's one month of good sales. It was well received by the market. We see some continuing momentum here in the early parts of July. But I want to be very cautious with that statement.

We also are managing, as Sherry and I have both addressed in our earlier comments, we are also addressing our margins better. So that's coming in well. We see a little bit less of devaluation impact recently, particularly in Colombia for the month. I mean it's still significant. But relative to what was, it's abated a little bit. And you know, I think that's about as far as I would want to go.

Rodrigo Echagaray: Great. Very useful. Thank you, guys.

Operator: Thomas Vester of LGM.

Thomas Vester: Just on the margin, and maybe I can ask it a little bit differently, what same-store sales level should you be at before you're comfortable on seeing margins sort of trending back to what you historically had? So I'm trying to understand what level because clearly, the same-store sales in U.S. dollars is beneficial for margin. But what level do you feel it takes to really see that swing back in margin, because it has been compressed for quite a while?

Maarten Jager: Well, I appreciate the intent behind the question and trying to link sales to margin. Obviously, there is a relationship. But first and foremost, we're focusing on driving same-store sales through excellent merchandise. You know, I'm sure, from studying our business model and we know that the business model works best when you have same-store sales kind of in the middle single digits to higher, because then you start to leverage your expenses, your variable expenses that increase with inflation and wage increases, et cetera, as well as the fixed increases. And that allows you then to reinvest in the value proposition. So I don't want to draw an explicit link between the two, although, I understand the intent behind your question. Same-store sales that we're driving, we're focused on excellent merchandise. We've cleared out some of what we had in excess in Q3. That in and of itself, of course, when you don't need to mark it down, will help your same-store sales, right? But really at the root of it is to make sure that we have an excellent merchandising offering for our members.

Thomas Vester: Okay. Great. Makes sense. Just my second question is on the more rural store in Panama you touched upon, Sherry. I mean two questions. First of all, when you say in terms of the evaluation that it's too early, but you see some promising signs, can you tell us something about when do you expect to be able to evaluate it? And secondly, what it is you're looking for? I mean obviously, there's a number of factors. But just it could be interesting to hear what you're really evaluating on, what are the key parameters that will tell you whether or not this is something you should decide to go ahead with elsewhere or not? So those two things would be helpful to get some clarity on.

Sherry Bahrambeygui: Well, the evaluation is ongoing. And obviously, one of the threshold questions is relative to the investment that was required in order to build the club and what it costs to run the club, the type of sales that we can generate out of that smaller footprint, and sales per square foot, those are things that we watch closely. And to the extent that we can grow sales with less of a real estate investment as a result of being in a secondary market and other savings that come along with a smaller footprint, that is a metric that we would pay close attention to and see if the returns are within our threshold, our required threshold that would allow us to have some confidence going forward with other locations.

Thomas Vester: Yes. Okay. And then that brings me to next part related to that, because I guess, the bottleneck for a long time and also that's been the [explanation], I guess, pre you becoming CEO and Maarten you CFO, has been one the biggest bottlenecks for PriceSmart has been sourcing real estate, especially in Colombia, but also other places.

I would assume, but I guess that's my question whether or not I'm right, that your model should be much more [fast] scalable if it proved to be something that you want to roll out in the second-tier cities, because real estate as a bottleneck should be much less because it should be easier to source in these cities. So you should be able to fast track that. But maybe that's the wrong assumption.

Sherry Bahrambeygui: That's certainly the hope. I mean, I'm sure you've noted on the last three investment calls, at least, we focused on the challenge of real estate for the company and how because of the cost associated with being in some of the central areas where we already do business, that real estate was becoming a more challenging barrier for us, and we're finding ways to solve for that. And one of the explicit approaches that we shared with the investment community was we were going to look for ways to do it by way of bringing down our cost in real estate through smaller formats where appropriate, where markets could support the type of sales that would justify the investment, and also by investing in our omnichannel capabilities to see if we can get merchandise to our members without the need for so much real estate by whether it's delivery directly from the merchants and from -- I'm sorry -- from the vendors or through eCommerce, but using all these different approaches to reduce the cost of real estate, so that we could have a healthy profit as a result of these additional clubs.

Thomas Vester: Yes. Okay. Makes sense. And just staying on real estate, I mean because you are right, Sherry, that we have seen a pickup in, I guess sourcing of new sites and converting them into new stores since you became CEO.

Can you talk a little bit about what you've done to the team there? I mean has there been additional resources put in? Has there been change of resource? I mean it definitely seems like something has happened.

Sherry Bahrambeygui: I can't take credit for it, other than to say that there's a renewed energy. There's a renewed energy. There's a renewed focus. There's a real commitment. There's express discussions. People are being challenged. They're being excited about the fact that we have forward momentum in an area that seemed to be lagging a bit for us. And we're hoping to continue with this momentum and build on it going forward. And I think our team is seeing that this could potentially open more doors for us in terms of markets and even existing markets. The concept of saturating the market is not so much the concern anymore if we can expand into secondary markets where it makes economic sense and business sense for us to do so. And we still have other markets that we can be considering outside of our existing markets.

So yes, there has been, I'd say a renewed energy, a renewed motivation.

Thomas Vester: Yes. All right. And then . . .

Sherry Bahrambeygui: And the commitment. Excuse me. And the commitment from leadership that we will provide the support that's needed in order to expedite our efforts in this area.

Thomas Vester: Yes. Okay. And does that in anyways, do you feel you have to compromise in terms of, I mean, your return targets, because you mentioned also return, [some of the more rules], though, I mean, clearly your return on capital is a key aspect for whether or not to plow on with others. But I mean I guess one of the ways also to convert more real estate is to sort of just pay up a bit. Do you feel you have to do that? Or has that not been the case?

Sherry Bahrambeygui: I'm sorry. I didn't catch the last part of what you said. Another . . .

Thomas Vester: Basically whether or not you feel in some of the sites to basically secure them, you basically had to compromise a bit on paying up? Because that is one way you can get real estate pretty quickly.

Sherry Bahrambeygui: Well, I mean at this point, we've got our own internal thresholds for -- we have a very active real estate committee of the board. We've got internal thresholds that we have to meet before a club will be approved. I can tell you, there's a lot of rigor that's applied to make sure that we don't overpay and that we're paying

relative to the return that we expect we'll get by virtue of the sale. So no, we're not compromising our standards, if that's another way of putting it.

Maarten Jager: Yes. I mean just to add to that, and I think I addressed this on prior calls, it is, as Sherry said, a very rigorous process. We look at all the financials. We look at it on an incremental basis. We use different financial lenses to determine whether something will actually add shareholder value. And those lenses include ROI. They include adjusted ROI. They include MBVs. All the different ways that you would expect, I think, any management team to judicially evaluate new projects.

Yes, some of the projects are more expensive in some of the areas that we're looking. But then, of course, we are making sure that we're going to get enough incremental sales and value from it and membership income from it.

Thomas Vester: Yes. Okay.

Sherry Bahrambeygui: So I mean to add a little bit more to this. We see the opportunities potentially here to being a little bit more nimble and tailored in the size and the formats of our clubs depending on the markets where we're putting them. So you can expect that if we're going to have another club in Bogota, which we think is a very fertile market for us, we're going to be paying more for that, but we expect the returns to justify it because of the opportunity that exists. And so we're going to be looking at it on a case-by-case basis. But I don't want to leave this conversation with an impression that we're only looking to secondary markets and we're only looking to lower -- we still have opportunities in very fertile markets like Bogota, that we are aggressively pursuing. But we're doing that in tandem with our efforts to expand into secondary markets, assuming that Veraguas continues to prove out as we expect it to.

Thomas Vester: Yes. Okay. That's definitely appreciated. Just, Maarten, on the working capital, what you've done there is also appreciated. But on the tax, maybe in my head it's a little bit hard to understand why -- I mean looking at the various corporate tax rates in the jurisdictions you operate in and also the corporate tax rate in the U.S., I mean, intuitively, there should be some room to lower the corporate tax rate [all for] PriceSmart going forward. But again, maybe help me if I'm missing something there.

Maarten Jager: I think you know our tax liability is principally, the overwhelming majority is generated out of the markets, the liability, the tax liability that we have in the markets where we operate, right? We generate very little income in the United States and have very little tax liability here.

As you know, because of tax reform, the tax rate, the corporate tax rate here in the U.S. declined significantly, kind of turned the whole balance upside down from the U.S. being higher than our markets to now being lower. And as a result of that shift, we've had to relook at our foreign tax credits, and some of those had to be revalued. And that's kind of what we're cycling through in this year.

Having said all of that, what we are always looking at is to optimize it in a judicious way, and we'll evaluate that going forward. And there are losses in the U.S., right? I mean, or reported as losses. I'd like to think of them as investments that we are making, for example, in our Aeropost business and our omnichannel capabilities. But we don't have income to generate to offset those, and so that has mathematically the impact of effectively raising our tax rate. But we are looking at the tax question overall and opportunities that we may have.

Thank you, Thomas. Operator, we have the opportunity for one more question.

Operator: Our last question comes from Charlie Carter of Ceredex.

Charlie Carter: Just two quick ones. The first is on going back to the June same-store sales number. I believe last year, Central America was just disrupted by a lot of the political unrest. So I want to double check that that's not sort of driving the improvement we've seen month-to-month. It sounded like, Maarten, by the tone of your voice, that you were kind of generally encouraged that it was a sort of a broad-based improvement. So I just want to make sure that it's not just a very easy comp for Nicaragua or, again, one of its neighbors.

And then lastly, I didn't hear any specifics on the new distribution center in Costa Rica. And I can't remember if that was already launched in the quarter or if that's coming. And so just what effect that might have on your margins. Thanks.

Maarten Jager: I'll have Sherry talk about Costa Rica. In terms of the comps, good question. And we have 13 markets. So it's never one kind of consistent story. There's a number of markets that are helping us, some markets that are still a little flatter. Nicaragua specifically has helped because we are lapping significant unrest a year ago. It was a drag on our comp a year ago, and it's helping us in June this year. But that's not the whole turnaround.

Sherry Bahrambeygui: And also, I mean we have other issues going in the other direction like in Honduras. So that certainly is a very difficult situation there with the mass riots and street closures, and we've even been on alert a few times getting ready to close our clubs down to keep our members and our employees safe. So that's a new challenge we have this year that we didn't have last year. So it's dynamic.

Charlie Carter: Okay.

Maarten Jager: And in Costa Rica?

Sherry Bahrambeygui: I'm sorry. On the Costa Rica RDC, so that is an opportunity that we see to allow us to flow merchandise in a manner that would be most cost-effective and allow us to have the net landed cost be as competitive as possible by being able to flow merchandise, for example, from Asia or even potentially Europe, directly to Costa Rica

as opposed to having to go through Miami and then have Miami then redirect to either Costa Rica or specific countries or clubs.

And a very in-depth study is going on now to actually look at our items and what is the most cost-effective manner to get that item from the vendor to the clubs. And in addition to just the cost of getting it to closer to the members and looking for savings there, there's a business practice that can be improved by virtue -- for example, in Costa Rica, that's one of our largest markets. And when we're able to aggregate merchandise in the Costa Rica RDC and then pulse it into the clubs on a shorter-term basis with real-time knowledge of what the needs are in terms of inventory levels and sales activities in each of those clubs, that will yield savings, it'll yield better or less out of stock and better sales, optimally.

So the Costa Rica RDC holds a lot of potential for us, but it does require studying and in-depth analysis of almost on an item-by-item basis frankly, as to how and where is that merchandise best flowed.

Stepping back for a moment. What we've achieved with the Costa Rica RDC, though, it still is in process in terms of the work that needs to go into it to maximize that potential. But what we've achieved with that Costa Rica RDC is optionality for our company, which I think is very important, not just from a financial standpoint, but from a supply chain standpoint, from a reliability standpoint. I mean dynamics are changing in the world. There's political unrest. There's tariffs. There's is tax law changes. By having that additional flexibility and optionality for the company, I think it's responsible and it's a smart business move on our part. Now it's up to us to make the most of it.

Charlie Carter: And just one quick follow-up. I know that we're running out of time. But on the tariff issue, I mean I guess, are you tariffed on anything that's imported into Miami and then rerouted to your stores?

Sherry Bahrambeygui: We have a free trade zone there, but I can't tell you with definitive (indiscernible) . . .

Maarten Jager: Well, so there's some merchandise that we get from China and that goes through free trade zones, and so that's not subject to tariffs. But there's other merchandise that we buy from U.S. suppliers that, in turn, came from China, that has been subject to tariffs. And so it's that part of it that we're really focusing on addressing. Does that make sense?

Charlie Carter: Yes, it does. But I guess I'm looking at it competitively. So anybody that you're competing with on a same product-by-product or SKU-by-SKU, they would be buying from the U.S. as well, so it's not as if you would be disadvantaged by tariffs because you're sourcing through the U.S., in some ways?

Maarten Jager: I think competitively that's right. But of course, with a lens on member value, we're looking for alternative ways of flowing that merchandise and trying to

leverage our supply chain as effectively as possible, including the free trade zones that we have.

Sherry Bahrambeygui: Yes. And to the extent we can source that merchandise and avoid the tariffs altogether, obviously there's a bias in favor of doing that. And by having the Costa Rica RDC, that allows us to do that more effectively.

Maarten Jager: Okay. Thank you very much. Operator, I don't think there are any more questions in the queue?

Operator: That is correct. This concludes the question-and-answer session. At this time, I would like to turn the conference back over to the management team for any closing remarks.

Sherry Bahrambeygui: I'd just like to say thank you all for your time this morning. We're very excited about the prospects for us moving forward. We're all very committed to working hard on behalf of our members, our employees, and, ultimately, our, shareholders. Have a good day.

Maarten Jager: Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.