

**PriceSmart, Inc. [PSMT]
Q1 FY2020 Earnings Release Conference Call
Friday, January 10, 2020, 12:00 PM ET**

Officers:

Michael McCleary; Senior Vice President and Interim Chief Financial Officer
Sherry Bahrambeygui, Chief Executive Officer

Analysts:

Jon Braatz; Kansas City Capital

Presentation:

Operator: Good day and welcome to the first-quarter FY20 financial results conference call.

[Operator Instructions]

Please note the event is being recorded.

I would now like to turn the conference over to Mr. Mike McCleary, Senior Vice President and Interim Chief Financial Officer. Please go ahead.

Michael McCleary: Thank you and welcome to the PriceSmart earnings call for the first quarter of fiscal year 2020. We will be discussing the information that we provided in our earnings press release and our 10-Q, both of which were released yesterday afternoon, January 9, 2020. You can find both documents on our new Investor Relations website at investors.pricesmart.com, where you can also sign up for email alerts.

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, January 10, 2020. Forward-looking statements include, 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 fiscal year ended August 31, 2019, as filed with the Securities and Exchange Commission on October 29, 2019. The Company undertakes no obligation to update the forward-looking statements made during this call.

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

Sherry Bahrambeygui: Thanks, Michael. Good day, everyone, and Happy New Year. Thank you for joining today's call.

Before reviewing our results for Q1 fiscal year 2020, I'd like to formally introduce you to Michael McCreary, our Interim Chief Financial Officer, who you just heard from. I'm very

appreciative of Michael's willingness to step up during this period and am enjoying working with him in this capacity. I'm confident in Michael's ability to lead the Finance team during this stage.

As previously shared, Michael joined the Company as Vice President and Corporate Controller in 2003 and was later promoted to Senior Vice President and Corporate Controller. He has a strong knowledge of PriceSmart's business, processes and all aspects of PriceSmart's financial reporting and corporate governance. And he's quite familiar to our Finance team and Board members. We're all looking forward to working with Michael in this interim role.

On my first call we spoke about our renewed focus on the Six Rights. Our mission continues to focus our efforts on the Six Rights of Merchandising and to drive our business forward by providing our members with an outstanding shopping experience and quality services at the lowest prices. This, along with our high standards and our commitment to our employees and the communities in which we operate, continue to define who we are and set us apart.

I'm proud of the team for their efforts over the past year and our results are starting to show momentum. Based on our solid finish to 2019 and Q1 results, we believe that we are well positioned for fiscal 2020. And we're pleased to report positive financial results for Q1 FY2020.

In the first quarter we had record Q1 revenues of \$811.9 million, an increase of 4.1% over the comparable prior-year period. Revenues consisted primarily of net merchandise sales of \$778.7 million, plus \$13.7 million of membership income and \$8.3 million of export sales, as well as \$11.2 million of other revenue and income. Currency fluctuations had a negative impact of 1.6% on net merchandise sales. Comparable net merchandise sales in our 41 clubs opened more than 13.5 months increased by 1%, with currency fluctuations affecting comparable net merchandise sales negatively by 1.5%.

In terms of merchandise category highlights, we saw sales increase in our overall foods and fresh categories, with strong performance in our pet supplies, grocery and deli departments. Although sales continue to yield positive results in these categories, we recognize that there is still opportunity to improve departments such as electronics, hardware and home furnishings.

So now let me give you more color by segment. In Central America, where we had 25 clubs at quarter end, merchandise sales grew 6.1%, with a 1.8% increase in comparable sales. Nicaragua and El Salvador led the way in this segment, reporting strong same-store sales growth in the low double digits, contributing to over half of the comparable sales growth in this segment. The impact of currency on total and comparable sales to the Central American segment were positive 0.3% and 0.4%, respectively.

In the Caribbean, where we had 13 clubs at quarter end, merchandise sales grew 4.4%, with comparable sales growth of 2.1%. Jamaica led the way in the segment, reporting low double-digit same-store sales growth. The impact of currency on total and comparable sales to the Caribbean segment were negative 2.1% and 1.9%, respectively.

In Columbia, where we had 7 clubs at quarter end, and the greatest currency impact, merchandise sales in US dollars declined 5%, with a 5.2% decrease in comparable sales in US dollars. However, we have solid sales growth in constant currency in Columbia. The impact of currency on total and comparable sales in Columbia was a negative 9.9% and 9.7%, respectively.

With regard to overall membership results, we finished the quarter with approximately 1.6 million accounts, which is a 50-basis-point increase since Q4 of fiscal 2019. Membership income was up 7.9% compared to the comparable prior-year period. The 12-month renewal rate at the end of November was 86.1%, an increase from 85.7% at the end of Q4 fiscal 2019 and 85% at the same time a year ago.

Total gross margins this quarter increased to 16.9% from 16.2% in Q1 fiscal 2019. Gross margin, when compared to the prior-year period was impacted primarily by favorable net merchandise margins. Net merchandise margins for Q1 increased 70 basis points to 14.9% versus the same period a year ago and is more in line with historical trends.

Net income for the first quarter of fiscal year 2020 increased 35% to \$19.7 million, or \$0.64 per share, compared to \$14.6 million, or \$0.48 per share in the comparable period of last year.

We ended this quarter with 45 warehouse clubs, compared to 41 clubs a year ago. The new clubs include 2 in Panama, referred to as Veraguas and Metro Park; one in the Dominican Republic, the Bolivar club; and most recently in Guatemala, the San Cristobal club that opened in November of 2019.

I had the pleasure of visiting several of our clubs in Guatemala, including participating in the November opening of the San Cristobal club, which is located in the southwestern side of Guatemala City, Guatemala. The San Cristobal club is PriceSmart's fourth warehouse club in Guatemala and the first to utilize the Company's smaller warehouse club format in that country. San Cristobal is our 45th club and we have 4 additional clubs that are scheduled to open this calendar year.

Now I'd like to take a moment and address comparable sales, current and expected, given the number of club openings. As I've mentioned before, these 4 clubs, in addition to the 4 new clubs announced for the upcoming 2020 calendar year, are likely to transfer some sales from existing more mature clubs, especially in the near term. We believe that the addition of new clubs in densely populated urban environments improves the member experience. Our investments and priorities are and have been established to create sustainable and long-term value for our members, employees, vendors and shareholders. So, though some of these clubs are within reasonable close proximity of existing clubs, these additional clubs also allow us to leverage our infrastructure and branding, enhance our presence in these markets and offer more convenience, which we recognize is of increasing importance to our members.

An additional factor on comparable sales is that we expect an impact this year in at least one of our Caribbean markets, where a competitor recently reopened after being closed due to severe storm damage in September of 2017.

So now to look at some of the initiatives we remain focused. They include our digital platform. In fiscal 2019 we launched a new digital membership capability for sign-ups, renewals and upgrades in all countries and launched [pricesmart.com](https://www.pricemart.com) to expand the offering of clubs in the Dominican Republic. In fiscal 2020 we're working on making our club inventory visible online in Spanish-speaking countries where we operate. We also expect that during fiscal 2020 in select markets our members will be able to make online purchases on [pricesmart.com](https://www.pricemart.com), with multiple

delivery and pickup options. As part of that effort, we're also working on the ability for individual and business members to use online to shop and collect their items at certain club locations.

In terms of enhancing the member experience inside of our clubs, we continue to strengthen our services portfolio by adding optical services throughout many of our clubs. Thus far in 2020 we've rolled out 7 additional optical service centers, bringing the total to 14 companywide, and we are expediting plans to roll out this service to most of our clubs.

Over the last year we've been and continue to work on our merchandise offering and inventory management. As an example, in the first quarter the fresh category penetration increased versus a year ago. This increase is mainly driven by our focus on expanding our prepared foods offerings and also developing our direct farm program. The direct farm program is showing encouraging results on several levels, but is still in early stages and we see good potential there. We believe this program gives us the opportunity to provide our members with special local produce at better value, increase our produce selections, reduce out-of-stocks, transact in local currency and, meanwhile, strengthen our relationships with and empower our local farmers and their communities.

We remain committed to making our clubs a positive and exciting place to shop. We work hard to keep our clubs up to date and safe by investing in remodels and sales floor expansions where and when needed. Last year we expanded 2 clubs. In addition, we improved food preparation and fresh areas, as well as added solar panels and parking lot canopies to various clubs. In calendar year 2020 we have plans to expand approximately 3 additional clubs and anticipate refreshing several clubs to ensure our members have an enjoyable and compelling shopping experience.

Another priority for 2020 includes our commitments to our employees by investing in their development and providing them with good compensation and benefits. For example, we are pursuing our cross-function rotational program to strength collaboration, provide growth opportunities for our employees and to ensure we can staff and support new clubs with experienced employees who are well versed in the Six Rights of Merchandising, as well as build our pipeline for succession. We recognize that our short- and long-term ability to deliver on our mission is only possible because of our dedicated groups of talented employees.

We also understand the importance of supporting and developing the communities in which we operate. In conjunction with Price Philanthropies, we are very proud of the Aprender y Crecer school supply program. In fiscal year 2019 alone, Aprender y Crecer provided more than 100,000 students with school supplies. We see it as our responsibility to be a positive influence in our communities.

Before I turn the call over to Michael, I want to talk briefly about December sales that we released earlier this week. Net merchandise sales were a record \$362.1million, an increase of 4.3% versus a year ago, with a negative FX impact of 0.3%, or \$1.1 million. Net merchandise sales in December represented the highest monthly sales in the history of our company.

In closing, we remain focused on driving growth through a balance of new warehouse club openings, comparable store sales and increasing membership by providing outstanding service

and value to our members. We will also continue to focus on initiatives that we believe will drive the Company towards long-term success and increased shareholder value.

Most importantly, I want to thank our employees for their continued commitment and their intense engagement during this past year. We've made important progress as a team. We look forward to working hard on the core strategies that drive healthy, sustainable growth while having a positive impact in our markets.

Thank you for the opportunity to share this information with you today. I will now turn the call over to Michael.

Michael McCleary: Thank you, Sherry, and good morning or afternoon to everyone for my first conference call as Interim CFO. I look forward to leading our great Finance team during this transitional period as we continue to support the rest of the organization to implement our long-term growth and profitability goals.

As Sherry discussed earlier, during the first quarter of fiscal 2020 total revenues were \$811.9 million, an increase of 4.1%, and gross margins rose 70 basis points, both when compared to the first quarter of fiscal 2019.

Total SG&A expenses as a percentage of total revenue was 13.1%, remaining flat versus a year ago. However, our comparable Q1 fiscal year 2019 SG&A total included a one-time \$3.8 million charge related to the departure of our former CEO, which represented a 50-basis-point impact in that period. The increase year over year after considering this one-time impact in the prior period, was primarily driven by our investments in talent and expenses related to the opening of our 4 new clubs, including pre-opening expenses.

Operating income was \$30.7 million, or 3.8% of total revenue in Q1 fiscal 2020 versus \$24.7 million, or 3.2% of total revenues a year ago. The improvement is largely due to higher net merchandising margins in the first quarter of fiscal 2020.

Below the operating income line, total other expense, primarily related to FX losses, decreased from \$2.5 million to \$1.6 million when comparing Q1 of this year to the prior-year period. The current-year losses were partially offset by a \$700,000 credit received for the settlement of escrow balances related to our Aeropost acquisition.

Our effective tax rate for the first quarter of fiscal 2020 was 32.3% versus a rate of 33.9% a year ago. While quarterly rates may vary based on specific events in those quarters, our current forecast for the full year of fiscal 2020 continues to be for an effective tax rate in the 35% to 36% range.

Net income increased 35% to \$19.7 million with diluted earnings per share of \$0.64 in the first quarter of fiscal 2020 compared to \$14.6 million with diluted earnings per share of \$0.48 in the first quarter of last year, which included a \$0.13 charge related to the departure of our former CEO.

Moving on to the balance sheet, which remains very strong, we ended the quarter with cash, cash equivalents and restricted cash of \$115.1 million, an increase of \$26.7 million compared to the

same period last year. During this period cash provided by operating activities decreased \$9.6 million versus the same quarter last year, primarily due to the earlier holiday inventory buildup this year and an increase of inventory from the additional 4 clubs opened over the last year, which was partially offset by improvements in our average inventory on a per-club basis.

Net cash used by investing activities increased by \$16.3 million, primarily due to net increases in short-term investments. Net cash provided by financing activities increased \$40.8 million, primarily due to new long-term borrowings in Columbia and temporary drawdowns of \$15.6 million on our short-term credit facilities.

On a more technical note, this quarter we adopted the new lease accounting standard. As a result, we recorded \$130 million of lease liabilities representing the net present value of expected future minimum lease commitments for our operating leases. It is important to note that, while this change did not have a direct impact on our net income, \$34 million of the lease liabilities we recorded are for US-dollar-denominated leases in countries which operate in other currencies. Therefore, fluctuations in the exchange rate between these currencies and the US dollar could impact our P&L on a go-forward basis as these liabilities are revalued in local currency quarterly.

In closing, we have reaccelerated our growth and improved the member experience by adding 4 new clubs over the past year and we are excited about the 4 additional clubs we have in the pipeline that will bring our total to 49 clubs in 12 countries and 1 US territory by the end of 2020. We believe that our renewed focus on the Six Rights is driving improved merchandise assortments and is enhancing our members' shopping experience, resulting in improved membership renewal rates. We are encouraged by our start to fiscal 2020 and look forward to reporting our results next quarter.

Operator, I will now turn it back to you.

Questions & Answers:

Operator: We'll now begin the question-and-answer session. [Operator Instructions] The first question comes from Jon Braatz, Kansas City Capital.

Jon Braatz: Good morning, Sherry, and welcome, Michael. Sherry, just a couple questions. Your gross margins have been improving and, as you said, approaching back to historic levels. As you look forward and you see other opportunities to improve gross margins, at that point do you begin returning some of that improvement back to the consumer, your customer? Once you get to the point where you're back to historic levels do you begin to return some of that to your customers?

Sherry Bahrambeygui: Well, Jon, as you're very familiar with the fundamental discipline of our business, we attempt to squeeze out all inefficiencies such that we can provide a great value, a compelling value, to our members. And we try to maintain margins within a very tight range such that we can give back to our members by basically driving volume through lower pricing and getting better opportunity to purchase merchandise at better prices so that we can then sell that at a better and more compelling value to our members.

So indeed our discipline is to compress margins as much as is responsible, given all of the circumstances, given our cost structure and given the appropriate margin structure for each type of category that we have in terms of both goods and services that we offer our members, so that we can offer the most compelling prices possible to our members in order to increase the value of the membership.

So, in short, yes, it does go back to the member.

Jon Braatz: Okay. Okay. So, we're at those historical levels now and really it would be difficult necessarily to see much additional improvement in margins. At that point you'd begin returning some of it to your customers.

Sherry Bahrambeygui: You know, I hesitate to give a blanket answer to that. But generally speaking, our goal is to give back the benefit to the members to drive volume, yes.

Jon Braatz: Okay. All right. Thank you. And then, secondly, in the past few quarters you've given us a little update on your Aeropost spending and your online spending and the impact it has had to the bottom line. And I think it was, like, \$0.12 or \$0.13 last quarter or something like that. I didn't see that in the 10-Q and I'm try- -- can you give us a little sense of what that total spending is costing you relative to maybe last quarter and last year and maybe how you see that going forward?

Sherry Bahrambeygui: What I can share with you is it's generally in line with what it's been. And obviously we are investing in talent and making sure that we have the appropriate resources to support and fund the business objectives of building our online capabilities. But in the near term I don't have any material deviation to share with you. I think you can see we're in line with where we've been but, again, making the appropriate investments as we need.

Jon Braatz: And when do you expect those investments maybe to tail off a little bit and ease somewhat? Are we talking 2021 or would you anticipate those spending levels to be rather consistent with what you might be seeing in 2020?

Sherry Bahrambeygui: Well, what I can share with you is that building a robust e-commerce and digital platform is a dynamic process and the more capabilities that you intend to include the more investing that it requires. There's not -- I can't tell you when it would necessarily tail off or even potentially require additional investment at this point. All I can tell you is that for the near future we're pretty much in line with what we've been spending.

But, again, the commitment is that we're going to build this platform and we're going to do it right and we're going to do it in a responsible and methodical way. And we're going to make the investments that are reasonably required as we go.

Jon Braatz: Okay. Thank you. And one last question, Sherry. You've had a couple of your small-format stores open for a short period of time. Anything you've learned from those stores that maybe were unexpected, either positive or negative? Anything you might be able to add on what you're learning?

Sherry Bahrambeygui: We're in the process currently -- because most of these stores have not

been opened, or these clubs have not been opened, very long but we're actively in the processes of scrutinizing the performance of these clubs, seeing where we've been exceeding expectations and where we've been falling short of expectations and what lessons can be learned from that as we consider future potential clubs using this format.

So, for example, in Bolivar, as we were very up front about, that was a club that has a lot more attributes as being experimental for us where we're trying different things to see what works and what doesn't work well. Veraguas, which is a very different club -- even though it's a small format it's in more of a remote location in a secondary market that allows us to expand the reach of our membership. And we're learning different lessons from that and seeing areas where we can improve, but also some positive signs from that as well. But we're in the process of studying it. It's relatively new right now for me to be able to comment any further on it.

Jon Braatz: Okay. Appreciate it. That's it, Sherry. Thank you much.

Operator: [Operator Instructions] This concludes our question-and-answer session. I'd now like to turn the conference back over to Mr. Michael McCleary for any closing remarks.

Michael McCleary: Okay. Thank you, everybody, and we look forward to talking to you next quarter.

Sherry Bahrambeygui: Thanks, everyone. Bye-bye.

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