

PriceSmart, Inc. [PSMT]
Third-Quarter Fiscal Year 2021 Earnings Call
Friday, July 9, 2021, 12:00 PM ET

Company Participants:

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

Analysts:

Jon Braatz; Kansas City Capital

Presentation:

Operator: Good afternoon, everyone, and welcome to PriceSmart, Incorporated's Earnings Release Conference Call for the third-quarter fiscal year of 2021, which ended on May 31, 2021.

After remarks from our company's representatives, Sherry Bahrambeygui, Chief Executive Officer, and Michael McCleary, Chief Financial Officer, you will be given an opportunity to ask questions as time permits. As a reminder, this conference call is limited to one hour and is being recorded today, Friday, July 9, 2021. A digital replay will be available following the conclusion of today's call through July 16, 2021, by dialing 1-877-344-7529 for domestic callers, or 1-412-317-0088 for international callers, and by entering the replay access code 10156316.

For opening remarks, I would like to turn the call over to PriceSmart's Chief Financial Officer, Michael McCleary. Please proceed, sir.

Michael McCleary: Thank you, and welcome to the PriceSmart earnings call for the third quarter of fiscal year 2021. We will be discussing the information that we provided in our earnings press release and our 10-Q, which were both released yesterday afternoon, July 8, 2021. You can find these documents on our 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 plans, revenues and related matters. Forward-looking statements include, but are not limited to, statements containing the words expect, believe, will, may, should, estimate and similar expressions. All forward-looking statements are based on current expectations and assumptions as of today, July 9, 2021. These statements are subject to risks and uncertainties that could cause actual results to differ materially, including the risks detailed in the Company's most recent Annual Report on Form 10-K and other filings with the SEC, which are accessible on the SEC's website at www.sec.gov. These risks may be updated from time to time. The Company undertakes no obligation to update forward-looking statements made during this call.

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

Sherry Bahrambeygui: Thank you, Michael. Good day, everyone. Thank you for joining us and for your interest in PriceSmart.

We're pleased to report strong results for our third quarter of the fiscal year and we're seeing continued sales growth as we enter the final quarter of this fiscal year. For the quarter, net merchandise sales grew

11.6% and comparable net merchandise sales grew 8.8% compared to the same quarter last year. Our trailing-12-month membership renewal rate was 87.6% as compared to 82.5% for the same period ending May 31, 2020. And our total membership accounts have just about recovered to the level they were shortly before COVID.

These third-quarter results were achieved in part because of operational efficiencies, digital capabilities, expanding options for our supply chain and, most importantly, our dedicated team that has become quite nimble at adjusting to rapidly changing dynamics brought on by the pandemic. Also contributing to the Company's performance are the investments we've made in talent, technology and analytics. Generally speaking, our access to timely and high quality information is supporting better decision making, greater efficiencies and our understanding of members' needs and preferences.

We also feel that the actions we've been taking to protect our employees and members and their safety has further enhanced our members' trust in us. We believe that our renewed focus on the fundamentals of our business, which I've discussed in prior calls, has also contributed to positive results. For example, as compared to the pre-pandemic period in FY 2019, warehouse productivity has increased and in inventory management we've reduced markdowns, salvage, throwaway and demurrage. We've increased inventory turns by almost 20% for the nine months ending May 31, 2021 compared to the comparable period in 2019, and we've achieved lower out-of-stock. These key metrics have improved relative to the comparable time in 2019, despite the challenges we've been experiencing because of the pandemic.

Now let's turn to our markets. During the third quarter we delivered significant sales growth in Central America versus the same period last year. Our business in the Northern Triangle countries of Honduras, Guatemala and El Salvador has rebounded strongly in fiscal 2021 when compared to the prior year.

We did experience some softness in net merchandise sales in our Caribbean region, primarily driven by Trinidad, due to a dramatic resurgence in COVID infections. In May, the government of Trinidad responded with lockdowns and significant restrictions that resulted in a 50% reduction of our club capacity and our sales being limited to only groceries and essential goods. This, coupled with our decision earlier in the year to limit US imports to Trinidad because of the ongoing challenges converting currency, led to a significant decline in net merchandise sales in that market for the quarter.

Colombia also suffered a COVID resurgence during the quarter, as well as civil unrest in significant portions of the country, where protests interfered with the country's infrastructure and public transportation. Roadblocks choked off major arteries and the disruption to the flow of merchandise and raw materials to produce goods impacted not only us, but the businesses of many of our suppliers. Despite all of this, Colombia delivered impressive sales growth for the quarter.

In terms of merchandise, we saw our non-foods category, comprised of both hard lines and soft lines, strongly rebound this quarter with 41% sales growth compared to the same quarter in the prior year. Our merchandising teams have done a great job of anticipating demand and working with our global suppliers to procure high-demand inventory that has been difficult for our competitors to procure.

As a result, our hard-line category experienced approximately 31% comparable sales growth compared to the prior-year quarter. Virtually all categories in that segment had growth, but the leaders were business machines, housewares and small appliances, which grew 69%, 36% and 35%, respectively. Our overall soft-line category grew 66%. Casual apparel grew 84% and basic apparel grew 86%. We're seeing the pendulum swing in consumer behavior, from the stockpiling and surged demand for essentials in Q3 of last year to an increased demand for discretionary items this year. Due to the COVID stock-up in the prior-period quarter, as expected, we experienced comp declines year over year in our canned food, grain

and grocery categories, which were largely offset by a rebound in other categories, such as candy, nuts, soda, beverages and liquor. Overall our food category remains steady.

Our fresh category grew 8% this quarter versus Q3 of last year, with poultry, meats and gourmet deli leading the way with 21%, 13% and 13% growth, respectively. We're seeing growth in our high-quality fresh product sourced through our Direct Farm Program. Our Direct Farm Program, to remind you, reduces cost and improves the quality of our fresh produce offerings, while also supporting local farmers and industry.

Our new Produce Distribution Centers allow us to provide farm-to-table produce more efficiently and at a better value than purchasing from distributors. We have two produce distribution centers in operation in Panama and Costa Rica and we expect to open two additional produce distribution centers in other markets next year.

Our Other business category yielded 41% comparable net sales growth, led by our bakery and food service, which grew 35% and 32%, respectively. This occurred despite some markets remaining subject to food court capacity restrictions. Although we've seen a significant improvement in capacity relative to this time last year, we have not yet returned to normal.

Turning to supply chain and inventory, our merchandising and logistics teams continue doing a great job sourcing inventory despite the continued global shortage of shipping containers at the point-of-origin in Asia and the general supply bottleneck due to the closures of certain factories and facilities. So ramp up of demand for certain goods has stressed the global supply network and certain inventory categories continue to have delays. We also experienced supply chain difficulties in Colombia due to the civil unrest that I discussed earlier.

In response, as I mentioned in our last earnings call, we've made strategic inventory investments in various non-foods departments, in part to front load orders of several items. Additionally, we have better real-time data to manage our supply chain and we've established relationships with new vendors which provides us with alternative sources for key merchandise. Lastly, by expanding our distribution system we have more options for transporting merchandise from our vendors to our clubs, which has been key for mitigating supply chain disruption.

We don't know when these shortages will ease, but we believe that we are prepared for this to continue to some degree throughout most of this calendar year. As a result of the shortages and supply chain disruptions, transportation costs have increased significantly, due to port delays and container shortages and we're seeing increases in shipping costs. We've also seen inflationary price pressures, with significant increases in the commodities that are input to our vendors' products, as well as waste increases in certain markets. Despite these issues, our team has done a great job of mitigating cost increases and supply chain delays in its continued efforts to provide the best value for our members.

Our average inventory per club is significantly higher versus the comparable prior-year quarter, in which we experienced the rapid sell-through of merchandise as members stockpiled items. Last year we also intentionally reduced certain non-food categories to align with initial consumer preferences. This increase in inventory per club reflects our intention to bring our inventory levels back in line with more historic sales trends. Also, as I mentioned, we've made strategic investments in inventory to guard against potential future price increases.

Turning to omnichannel, last year when members couldn't access basic goods because of club closures and restrictions, we took urgent measures to take care of our members and we launched Click & Go curbside and delivery service. During Q3 Click & Go represented 3.5% of our net merchandise sales.

Curbside pickup and delivery is now available at all of our clubs and all of our markets. Over the past several months, delivery continues to become a larger portion of our total Click & Go sales. Our grocery, health and beauty and cleaning departments are currently the best performers on our e-commerce platform.

We're also pleased to see members using our online platforms to sign up and renew their memberships. 15% of all new signups fiscal year-to-date were completed online. That's up from 14% for the six months ended February 28, 2021, and 5% in the year-ago period. Online member sign-ups and renewals provide several advantages to us, including the opportunity for auto renewal and auto payment and access to high quality, accurate and valuable information. Our experience with Click & Go has not only shown us the demand for the service, but the value of the data generated by our e-comm and online channels. As a result, we've created significant sustainable growth possibilities for our business.

Now turning to memberships, our total number of membership accounts increased 3.5% during the third quarter of fiscal year 2021 when compared to the comparable prior period. Our trailing-12-month renewal rate was 87.6% and 82.5% for the periods ended May 31, 2021 and May 31, 2020, respectively. This renewal rate of 87.6% is higher than our pre-COVID levels and has significantly improved from the low of 80.5% at the end of August.

Another encouraging sign that our members recognize the value in our membership is the growth of our Platinum program. As a proportion of our total membership account base, Platinum has grown fiscal year-to-date versus last year's comparable period and is available in all of our markets. And, as mentioned earlier, a growing portion of our members are engaging with us online. Through virtual chats and social media we have systems and platforms in place to interact real time with our members. This enables us to provide better customer service and gain current data, including trends and insights to preferences. This also provides us with valuable information that informs our business decisions.

Now looking at real estate, we're currently constructing a new smaller-format warehouse club in Bucaramanga, Colombia that is expected to open in the fall of 2021. This will be our ninth club in Colombia. We believe the smaller-format clubs, coupled with our omnichannel capabilities, extend our reach and presence in regional or secondary city locations and represent a significant opportunity for the Company to grow in these markets. We have two more club openings coming up, one in [Aranda,] Guatemala that is planned to open in the fall of 2021, and one in Portmore, Jamaica, scheduled to open in the spring of 2022, which will bring us to a total of 50 clubs.

And a quick note update on our member wellness initiatives. We now have 37 in-club optical centers in 8 of our markets. We plan to expand this service to almost all clubs by the end of this fiscal year. We've piloted pharmacy services in 2 of our clubs in Costa Rica and we also plan to expand to additional clubs in Costa Rica and Panama. We expect to open our first 2 audiology service centers this quarter in Guatemala under our member wellness umbrella and will be opening Aranda, Guatemala, the new club, with audiology services included.

Looking to the future, overall we feel positive about FY21, especially as we see memberships rebound and foot traffic to our clubs increase in most of our markets. As to the longer term, we've embarked on a multiyear growth plan which includes building the internal infrastructure needed to support faster growth. These initiatives will be buoyed by further investing in talent and technology. We plan to grow by expanding our brick-and-mortar footprint in conjunction with our e-comm platform in order to create a truly seamless omnichannel experience for our members. We plan to continue diversifying and expanding e-commerce -- excuse me, expanding our distribution and logistics system. And we intend to expand our private label product offering and identify additional opportunities for vertical integration. We also intend

to drive growth by continually increasing the value proposition we represent to our members, growing our member base. I look forward to sharing more on future calls.

To wrap it up, we're grateful for the trust that our members have placed in us to help improve their lives and businesses, especially during these trying times. And I'm especially proud of our more than 10,000 employees across 13 countries. It's been a very challenging 16 months for the team, but we're turning trials into triumphs. Our team is energized and motivated to grow and gain market share.

I want to thank you all for your time today and I'll now turn the call over to Michael.

Michael McCleary: Thank you, Sherry. Good morning or afternoon to everyone and thanks for joining us today.

Total revenues and net merchandise sales for the quarter were \$895.3 million and \$857.5 million, respectively, representing increases of 11.9% and 11.6% over the comparable prior-year period, respectively. As a reminder, including the clubs we opened in Liberia, Costa Rica in June 2020 and Bogota, Colombia in December 2020, we ended this quarter with 47 warehouse clubs compared to 45 warehouse clubs at the beginning -- at the end of the third quarter of fiscal 2020. Our comparable net merchandise sales growth was 8.8% for the 13 weeks ended May 30, 2021. Foreign currency fluctuations had a negative impact on both merchandise and comparable net merchandise sales of approximately \$12 million, or 160 basis points, and \$12 million, or 150 basis points, respectively.

By segment, in Central America, where we had 26 clubs at quarter end, net merchandise sales increased 17.7%, with a 16% increase in comparable net merchandise sales. Nicaragua, Honduras and El Salvador, along with our second largest market, Panama, contributed approximately 1,000 basis points of positive impact on the segment's comparable net merchandise sales. This increase was offset by an 80 basis point negative impact on the segment's comparable net merchandise sales from our largest market, Costa Rica. During the quarter, Costa Rica experienced foreign currency exchange headwinds, with the Costa Rican colon devaluing versus the comparable prior-year period.

In the Caribbean region, where we had 13 clubs at quarter end, total net merchandise sales declined 2.9% and comparable net merchandise sales declined 2.5%. The Dominican Republic continued its stellar sales performance during the COVID-19 pandemic, with double-digit sales growth, despite a significant foreign currency devaluation compared to the prior-year period. However, this gain was more than offset by weakness in Trinidad, where we have 4 clubs.

In Trinidad, comparable net merchandise sales declined 21.8% in the third quarter due to the resurgence in COVID-related cases and our continued reductions of US inventory shipments to that market, due to the U.S. dollar illiquidity situation. We were able to source additional tradable currencies during the third quarter compared to the previous quarters in fiscal 2021, and we continue to work on multiple projects to increase sourcing of US dollars, including exporting goods produced in Trinidad to our clubs in other markets.

Due to the current limitations on our ability to sell nonessential merchandise in Trinidad, we have further reduced our shipments of US inventory for the time being. As of the end of our fiscal third quarter, our Trinidad subsidiary had Trinidad-dollar-denominated cash, cash equivalents and short-and long-term investments measured in US dollars of approximately \$76.7 million, a decrease of \$20 million from our balance of \$96.7 million as of the end of our fiscal second quarter. The decrease quarter-over-quarter is due to a combination of improvements in U.S. dollar sourcing and the additional reduction of imported merchandise during the third quarter, which resulted in more sources than uses of U.S. dollars during this period. We will continue monitoring closely the evolution of the expected reopening of the Trinidad

economy during this current quarter, with an eye toward increasing imports into Trinidad as the local market and U.S. dollar liquidity conditions merit.

Moving back to segment sales, in Colombia, where we had 8 clubs open during the quarter, net merchandise sales increased 22.4% and comparable net merchandise sales increased 3.6%. The comparable net merchandise sales increase contributed 40 basis points of positive impact to total comparable merchandise sales for the quarter. The increase in Colombia during the quarter was primarily due to a foreign currency tailwind, partially offset by increasing COVID-19 restrictions and civil unrest that significantly impacted normal commerce in the market, particular in the city of Cali. The impact of currency on total and comparable net merchandise sales in Colombia was significant at positive 7.1% and 5.9%, respectively, for the quarter. Currency fluctuations are a constant challenge in Colombia and, although favorable to us this quarter, we continue to take actions to mitigate the impact of any future devaluations, such as the sourcing of locally produced goods and actively managing our sales prices and foreign currency exposure [there].

Turning to gross margins, total gross margin on net merchandise sales came in at 15.9%, a 200 basis point improvement over the same quarter last year. The 200 basis point increase was primarily driven by approximately 80 basis points of increase due to certain pricing actions we took to offset foreign currency exchange costs and COVID-related operating costs, 50 basis points due to the returning margins of our other business categories, such as food services and optical, compared to the prior-year period and the remaining 70 basis points is primarily the result of more focused merchandising strategies and inventory management that resulted in fewer markdowns and spoilage.

Total revenue margins increased to 17.8% of total revenues, an increase of 190 basis points versus the same period last year. This is the result of the higher gross margins of 200 basis points that I mentioned previously, partially offset by lower revenue margins from our casillero and marketplace business in the quarter of 10 basis points.

Selling, general and administrative expenses for the quarter were 13.7% of total revenues, an increase of 80 basis points versus the same period last year. In total, SG&A expenses increased \$19.7 million compared to the prior year. Warehouse club and other operations expenses contributed 20 basis points of the increase, primarily due to the fact that our new club in Colombia has not yet reached normalized sales levels. General and administrative expenses contributed the other 60 basis points of the increase, primarily due to investments to support our talent and technology development.

Operating income was \$36 million, or 4% of total revenue, in the third quarter of fiscal 2021 compared to \$24 million, or 3% of total revenue, for the same period last year. This reflects the increase in total revenue margin, primarily from net merchandise sales, of 190 basis points, partially offset by the 80 basis point decrease due to deleveraging of SG&A expenses over the comparable prior-year period.

Net interest expense decreased \$1 million for the third quarter, primarily due to lower short-term borrowing compared to the comparable prior-year period when we drew down on short-term lines of credit as part of our efforts to secure adequate cash to cover contingencies arising from COVID-19 related risks. We repaid all of these borrowings by the end of the third quarter.

Other expenses of \$2.3 million were primarily related to the costs to convert Trinidad dollars into other tradable currencies. Additionally, the Jamaican dollar appreciated, which resulted in an unrealized loss on our net US dollar asset position in that market due to our US-dollar-denominated cash reserves designated to fund the construction of our new Portmore club.

Our effective tax rate for the third quarter of fiscal 2021 came in lower than last year, at 30.9% versus 38% a year ago, primarily because of higher income in the quarter that reduced the impact of the loss of value of foreign tax credits compared to the same quarter last year. We continue to estimate that our full-year fiscal 2021 effective tax rate will be in the 33% to 34% range.

Net income for the third quarter of fiscal year 2021 was \$22.5 million, or \$0.73 per diluted share, compared to \$12.7 million, or \$0.41 per diluted share, in the comparable prior-year period.

Our balance sheet remained very strong. We ended the quarter with cash, cash equivalents and restricted cash totaling \$198.4 million.

While cash flow provided by operating activities decreased \$94.2 million versus the prior-year period, this decrease was primarily the result of the vastly different inventory financing strategies through the different stages of the pandemic between these two years. In the prior-year period we made a conscious decision to pull back on merchandise levels in non-food areas, whereas in the current period we have increased our position in these items to meet increased demand and to compensate for supply chain challenges.

Additionally, at the beginning of the pandemic we negotiated temporary extensions of vendor terms to assist in cash management activity. These extended vendor terms have, in large part, reverted to pre-COVID terms as of the end of the current period. However, we have been able to extend our vendor terms on a permanent basis with a substantial portion of our vendors, especially for long lead time items.

Net cash used in investing activities decreased by \$20 million compared to the prior year, primarily due to a decrease in construction expenditures and an increase in net proceeds from short- and long-term certificates of deposit related to management of our cash balances in Trinidad. The \$190.5 million change from cash provided by to cash used in financing activities is primarily the result of a net decrease in proceeds from long-term debt and net repayments of short-term borrowing. We continue to be vigilant about our cash position and ready to adapt to sudden changes in circumstances.

In the prior-year period we executed long-term loans primarily to finance land purchase and construction of several of our warehouse clubs and increased our short-term borrowings as part of our cash management strategy in the early stages of the pandemic. While some uncertainty and risks remain in our market, we feel confident in our operations and our ability to generate sufficient cash for our needs while also continuing to invest in the future. Therefore, during Q3 of this fiscal year we finished paying down the remaining short-term lines of credit which we had accessed as part of our initial COVID-19 response during the same period last year.

In closing, we are very pleased about the results of the current quarter and the momentum that we are gaining as we close out our fiscal year 2021. The investments we have made and are making in our future capabilities, combined with our commitment to our founding principles, has been the key to our success. Throughout the Company we stand together as one team, focused on delivering a great value proposition to our members in a responsible manner. We are looking forward to our potential for growth for years to come and to your support and engagement in our journey.

I will now turn the call over to the Operator to take your questions. Operator, you may now start taking our callers' questions.

Questions & Answers:

Operator: Thank you. [Operator Instructions] Today's first question comes from Jon Braatz with Kansas City Capital.

Jon Braatz: Sherry, obviously the situation in Trinidad is very fluid and I was wondering if there's been any change in Trinidad from the end of the quarter to where we are currently. Any difference, any change in that situation?

Sherry Bahrambeygui: There has been a slight easing of the restrictions on the sale of goods in our clubs because the government released an amendment to their order that is now allowing us to include things like construction products and hardware and paper and school supplies and essential things for business to be able to continue functioning. We still have significant items that we're not allowed to sell at this point, but what we're seeing currently is the pace of the threat of the virus is reducing and the government is looking for ways to start opening things up on a gradual and measured basis. So we're hoping to see more flexibility pretty soon, but until we hear from them directly, we don't know. So we get very short notice and we're at the ready when they tell us -- something is issued that says you can now sell this or that. And we make sure that we make the adjustments necessary to make them available for our members.

Also, we are taking into consideration that in Trinidad whenever you see these kinds of restrictions, there builds a pent-up demand. And so we're focusing on that to make sure that even though we may not be able to sell certain key items at the moment, we want to be really prepared to provide those items at the most compelling value as soon as the opportunity is given to us.

So we're standing by and we're doing everything we can to recapture what we may have lost as a result of the restrictions.

Jon Braatz: Okay. To the extent that maybe things open up again and with oil prices up and Trinidad being a energy-sensitive country, would you see maybe some improvement in the illiquidity situation, the conversion situation? Would you see that improving a little bit?

Sherry Bahrambeygui: Well, generally speaking, whenever there's improvement to an economy one would expect that that would lead to some improvement in terms of liquidity. But, Michael, I think you might be able to provide a better answer to that.

Michael McCleary: Yes, we're seeing very positive signs in this calendar year, especially versus the end of the last calendar year. Historically in Trinidad they've tended to be a falloff in liquidity in the second half of the year. So we don't want to get ahead of ourselves but, as you saw during the quarter, we did reduce substantially our dollar balance, partly because of the additional restrictions, despite our intention to start shipping in more merchandise. So we're keeping our eye on it. We're hopeful. I think certainly, although a big part of the Trinidad economy is based on natural gas and others, oil prices are certainly a bellwether, if you will. And I think that that's a good sign and we're hopeful that when things start to open up the economy will improve and we can continue to improve our liquidity situation there and continue to ship in more merchandise.

Jon Braatz: Okay. Sherry, one last question. This year you spent heavily on technology, on people, to improve that piece of your business. And certainly I expect you to continue to invest in that area. But will the pace of spending ease a little bit? Could we possibly see some leveraging of those costs next year compared to this year? Or will the spending still be at a pretty significant pace?

Sherry Bahrambeygui: Well, the approach we're taking to our spending to make sure that we are investing appropriately to build the capacities we need. We've already seen the benefits of, for example, certainly technology tools that have been developed for us and how that has really protected us, especially in this

very volatile environment, and has captured sales that we might have otherwise not been able to get. And although we're watching the spending, with each of these tools come significant benefits for us to be able to drive sales. So we're going to look at it in a measured way, but we really feel that by making these appropriate investments we're building the foundation for growth in the long term. And we don't want to be pennywise and pound foolish.

Jon Braatz: Right, right. Okay. All right. Thank you, Sherry, Mike.

Operator: And, ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to the management team for any final remarks.

Sherry Bahrambeygui: Well, I want to thank everybody. I hope people are safe and doing well and weathering our current environment, wherever you are. And we really appreciate your interest and support of our business, PriceSmart, and look forward to talking to you next quarter.

Operator: Thank you. This concludes today's conference call. You may now disconnect your lines and have a wonderful day.