

Event Name: PriceSmart, Inc., Third Quarter FY22 Financial Results Conference Call
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Officers and Speakers

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

Analysts

Rodrigo Echagaray; Scotiabank

Presentation

Operator: Good afternoon, everyone, and welcome to PriceSmart, Inc.'s, earnings release conference call for the third quarter of fiscal year 2022, which ended on May 31 of 2022.

After remarks from our company's representatives, Ms. 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, Tuesday, July 12, of 2022. A digital replay will be available following the conclusion of today's conference call through July 19 of 2022 by dialing 1-877-344-7529 for domestic callers or 1-412-317-0088 for international callers and by entering the replay access code 6291871.

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

Michael McCleary: Thank you, operator, and welcome to the PriceSmart earnings call for the third quarter of fiscal year 2022 that ended on May 31, 2022. 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 11, 2022. You can find these documents on our Investor Relations website at investors.pricesmart.com, where you can also sign up for e-mail 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, plan, will, may, should, estimate and some other expressions. All forward-looking statements are based on current expectations and assumptions as of today, July 12, 2022. 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, and welcome to our third quarter fiscal '22 earnings call.

Sales momentum continued during the third quarter, and we almost reached our billion-dollar mark again, but came in just shy at about \$999 million, just like last quarter. This is a company that is reporting sales of significant levels and is moving in the right direction. Net merchandise sales increased by 16.5% after a negative 2.3% currency impact and comparable net merchandise sales increased by 12.8% after having taken into account a negative 2.2% impact. Membership accounts grew to 1.75 million; that's a new record, and we came in with a strong renewal rate of 88.9%.

Although -- and I know the topic of interest today will be margins -- although our total gross margin dollars increased 4% over the comparable prior year period, merchandise gross profit as a percent of net merchandise sales was 14.2%, a decrease of 170 basis points from the same period in the prior year.

Now, as stated in our earnings release, like many other retailers, we have not been spared the impact of global supply chain disruption and abrupt shifts in consumer demands. Our hardlines and other non-foods categories are characterized by a higher penetration of imported items that tend to correlate with discretionary spending, and due to the long lead times on many of these items, commitments must be made many, many months in advance, if not, in some cases, about a year.

So for -- many months ago, we made strategic investments in inventory with the goal of remaining in-stock and capturing higher sales. Since then, the environment changed significantly. It's been characterized by global supply chain disruption, including Asia port closures due to COVID, container shortages, higher freight and fuel costs, inflation and sharp changes in consumer demands. This has disrupted the cadence and the flow of that inventory, and inflation has influenced consumer behavior by shifting the demand away from the more discretionary items and more toward the essential items. So as a result, we've been experiencing excess inventory primarily in the area of hardlines.

Now, in response, we have taken decisive action. We continue to do so, and we are working with the goal of swiftly selling through the excess inventory and quickly rebalancing our inventory mix. As a result, we have experienced higher-than-normal markdowns in Q3. Now, our plan is to handle this quickly and efficiently in order to be well positioned for the holiday season and to sell through almost all of this, possibly, by the end of Q4. We see this as a point in time. We've gained many new important insights as a result of this, and it is our goal and our expectation that we will return to healthy historical margin structures soon.

So when you look at our gross margin percentage in Q3, it was primarily impacted in two significant ways. The first is that there was a reduction of margin percentage of 100 basis points, which represents the markdowns taken below cost on what we identified as excess inventory for that inventory which sold in Q3 and for the excess inventory remaining on the books as of the end of May, which we expect will sell through the end of Q4. Many factors could impact that, things that are unforeseen at this point that could make it longer or shorter, but based on what we

currently know, everything is being designed to get the merchandise sold by the end of Q4.

There's another 35 basis points which relate to the higher cost of fuel, freight and handling, and this is as a result of having to pay the spot rate on some of our freight, which we did not pass on to the member in Q3. We do not expect to see this again in the next quarter. While we generally factor in all transportation and handling costs when calculating merchandise and selling price, this last quarter saw a disproportional amount of these costs that we didn't pass on to our members. The most significant was the swings on spot rates for non-contracted freight rates coming out of Asia.

There were other factors, including significant increases in U.S. transportation costs and third-party storage costs and handling expenses, which were required as a direct result of having this excess inventory, and there were also some factors that contributed to more margin compression that were unrelated to inventory, such as a reduction of our COVID accruals, not having the same need to accrue as much, as about 17 basis points as compared to last year, and we also took steps to increase compensation of our U.S. distribution center employees, given the competitive environment. But on an ongoing basis, due to the ongoing supply chain complexities, we do expect our inventory levels to continue to run a bit higher than historical levels, but we're really focused on reducing our days-on-hand of inventory directionally toward more historical levels over the next several quarters.

To give you an order of magnitude on the margin percentage compression that we expect beyond that which you're seeing in the third quarter, we estimate that going forward, as it relates to excess inventory, we expect the margin percentage compression to continue somewhere in the range of 25 to 50 basis points through approximately Q4.

We share this with you because we see this as a point in time. We see this as a situation that obviously we weren't happy about, but we addressed as soon as it came to our attention what we were dealing with, and we've been aggressive or proactive in making sure that we do everything we can to sell through these items without delay and get back to our core business with our standard inventory balance and inventory mix and with our more customary margin structures. So in order to give you some sense of why we believe the margin compression will be substantially less than you're seeing in Q3, we're sharing with you what is our current best assessment of the range we're likely to see in Q4 of margin compression.

So now, resulting -- to the results of our third quarter, our total membership base grew to a record 1.75 million accounts, representing growth of 6.6% versus last year. Our 12-month membership renewal rate was 88.9% and our membership income was a record \$15.4 million, an increase of 7.8% over the same period last year.

So now we can look a little forward into Q4 for the month ending on June 30, '22. Total net merchandise sales was \$321.4 million, an increase of 15.5% over the same period in the prior year, and comparable merchandise sales for the four-week period ended June 26, '22, increased over 11.8% compared to the comparable period last year. Currency fluctuations continued to negatively impact net merchandise and comparable net merchandise sales by 2.5% and 2.8% respectively in the fourth quarter so far in June.

Trinidad also has had significant club closures and a prohibition -- or had a significant series of club closures and a prohibition on the sale of non-essential merchandise in the prior year. The impact of the increase in Trinidad sales this June versus June 2021 is favorable by 2.3% and 3% on net merchandise and comparable net merchandise sales respectively. So we're very pleased with the continued strong sales growth and believe that that provides a solid foundation as we head into the last quarter of this fiscal year.

So now I'd like to turn to our growth drivers, as we've described on calls before, the first being in real estate, expanding our geographic footprint, whether with clubs or distribution centers; second, continually enhancing the value of the membership itself; and third, driving incremental sales through [pricesmart.com](https://www.pricemart.com), as well as the technological capabilities that we're creating and investing in with our technology and talent investments.

So with this, we'll start with real estate. We celebrated our fiftieth club milestone with the opening of our Portmore club in April, and that was our second club in Jamaica. I was there, and the support and reception that we received in Jamaica was pretty impressive. We are a big presence in that market and we're very well respected, and we had -- just by virtue of the dignitaries that attended the event and the opening, it was clear that they do see us as providing tremendous value in that market, and hopefully that translates into how closely they'll be working with us in the future. So Portmore was very well attended, and total new signups were 25% higher than what we had originally expected in the first month of the opening. And our net merchandise sales beat our forecast by over 12%.

Now, this club was really important to us because Kingston, which has been the only club in that market for a long period of time, has been generating sales and activities that are record-breaking out of one club. The pressure on Kingston was beyond that which we wanted to expose our members to. Lines were getting long. It was very difficult to efficiently get in and out of that club. And it was important for us to enhance the experience of the members, so we opened Portmore with the expectation of shifting some of the sales over and enhancing the overall experience of our members in Jamaica. What we've found so far is yes, sales have shifted somewhat, but not nearly as much as we expected, and Portmore has really been doing well in its own right. So we're very excited about the results in that market so far, what we're seeing so far, and optimistic about the future.

And our real estate team has been busy. We've added two clubs -- we've added two additional clubs into the construction pipeline. Yesterday we announced that in the spring of 2023 we expect to open a smaller-format warehouse club located in the city of San Miguel, approximately 100 miles east of the capital city, San Salvador, in El Salvador, and this will be our third club in El Salvador.

As we fine-tune these -- what we call these smaller club formats, we're continually finding ways to extract more sales potential with less capital expense and less square footage overall for our buildings. And I'm excited to see, in the most recent iteration we have, we've been able to increase pallet counts, increase the proportion of sales floor within the same envelope, and so the small format, when we reference it, I just want to make sure you know, it's not a fixed concept.

It's one where we're basically saying, can we do more within the real estate footprint that we need in order to have a successful club in a specific market, whether it's urban or it's secondary, and efforts continue to make that more and more effective, whether it's by virtue of the features we put in that specific club or choose not to put, or through the enhancement of its capacity to put through merchandise and inventory because of additional support on the distribution side -- from the distribution center.

So now, we are also proceeding with the construction of a smaller-format warehouse club in the affluent El Poblado area of Medellin, Colombia. We expect to open this warehouse club, which will be our second club in Medellin, and the company's tenth warehouse club in Colombia, in the summer of 2023. Once these two new clubs are open, we'll be operating 52 warehouse clubs, and we're actively exploring other options as well.

Another part of our real estate strategy focuses on the important role of our distribution facility to optimize efficiencies and reduce risk, and also to take some of the functions and storage that we would normally rely on or historically rely on coming from the club, and shifting it out to a distribution location, where that distribution location could support multiple clubs and allow us to increase our efficiencies. So we're currently analyzing new locations for local distribution centers in several areas that would serve our Central American, Caribbean and Colombia markets. We're also reviewing potential sites in the Northern Triangle countries for a regional distribution center. This would give us a near-term option to create alternative routes for imports from Asia for distribution to our markets and represents further investment and job creation in these important markets.

Our sustainable packaging plant in Trinidad is another exciting project that we're involved with. It will start or we're planning for it to start about the end of August, and it covers many of the company's really important objectives: one, it allows for more near sourcing. It brings products -- producing products -- by producing products closer to our markets, and it supports that. It is a form of vertical integration, because we would be eliminating intermediaries with regard to the purchase of packaging and labeling, or the services. And with regard to our B2B business, as sustainable packaging, in addition to complementing our product offering, we believe we may have a really good market with our business members. It's an item -- the packaging is an item that would serve under our private label and have the benefits of what we shared with you about our private label, and it's one that we could sell to -- not only use for ourselves, but sell to our members.

And in terms of ESG, the items that are envisioned to be produced in this packaging facility will be either compostable or will use recyclable input, and that really does support our efforts to improve our performance in a manner that is environmentally responsible. And with regard to the liquidity, liquidity issues and challenges that we've had in Trinidad, this is an opportunity to allow us to generate more U.S. dollars to support our Trinidad operations by exporting these items to our other markets. So it's a built-in way for us to convert TTs to U.S. dollars, which is something that, although we've made great strides on reducing the balance, and Michael can share more about that with you later, but it's a way to do it naturally and not have to seek exchange to U.S. dollars outside of the ordinary course of business.

So with regard to membership benefits, which is our second driver, I want to share with you a little bit about what we're doing there. During the first nine months of fiscal 2022, our private-label sales represented 24.2% of our total merchandise sales. That's up 250 basis points from 21.7% in fiscal year '21. We've talked about the benefits of private label being a unique differentiator from our competitors, that people cannot purchase without the membership, and we usually have an opportunity to offer the same or better-quality merchandise at a lower price than the leading brands. So that provides greater benefits to the members.

Hang on a second. Unfortunately, my computer just shut down. Michael, do you want to take over your section, and then we can come back to the balance of this?

Michael McCleary: Okay, I will do that. So, thanks, Sherry. Good morning or afternoon to everyone, and thanks for joining us today to talk about our third quarter results.

Total revenues and net merchandise sales came in at \$1.03 billion and \$990 million for the quarter respectively, increases of 15.1% and 16.5% over the comparable prior year period respectively. We ended this quarter with 50 warehouse clubs, compared to 47 warehouse clubs at the end of the third quarter of fiscal 2021. Our comparable net merchandise sales growth for our fiscal third quarter was 12.8% for the 13 weeks ended May 29, 2022. Foreign currency fluctuations had a negative impact on net merchandise sales, and comparable net merchandise sales growth of 2.3% and 2.2%, or approximately \$19.1 million and \$18.6 million respectively.

By segment, in Central America, where we had 27 clubs at quarter end, net merchandise sales increased 12.7% with a 9.7% increase in comparable net merchandise sales. Foreign currency fluctuations had a negative impact on both net merchandise and comparable net merchandise sales growth in Central America of approximately 2.8% during the quarter. All of our markets in Central America had positive comparable net merchandise sales growth except for Guatemala, which had a small negative comp due to sales transfers from other clubs following the opening of our new Aranda club.

In the Caribbean region, where we had 14 clubs at quarter end, all of our markets had positive comparable net merchandise sales growth, with total net merchandise sales increasing 21.4% and comparable net merchandise sales increasing 17.4%. Trinidad and Tobago net merchandise sales increased 22.8% for the quarter and contributed 1.9% of the total net merchandise sales growth of 16.5%. The significant improvement versus the prior period was due to COVID-19 closures last year, combined with our decisions to increase imported inventory levels in the current period to meet current demand, which has helped to increase sales, as our ability to source additional U.S. dollars has improved.

In Colombia, where we had nine clubs open at quarter end, net merchandise sales increased 25% and comparable net merchandise sales increased 18.1%. These significant growth levels were achieved despite the impact that the devaluation of the Colombian peso had on merchandise and comparable net merchandise sales growth in Colombia of approximately 7% and 6.8% respectively during the quarter.

In terms of merchandise, we saw our food category grow approximately 10% compared to the

same quarter in the prior year. Our cleaning, beverages and oils and condiments departments led the way with 11%, 33% and 23% growth respectively. Our fresh category grew 14% compared to the same quarter in the prior year, led by our poultry, seafood and meat departments, with 18%, 15% and 11% growth respectively. Our non-foods category, where we took significant markdowns in several areas, such as sporting goods, garden and patio and TVs, grew 18% compared to the same quarter in the prior year. Improved conditions in Trinidad and Tobago also boosted sales growth for our non-foods categories, as these categories have generally performed quite well in this market. Finally, our other business category rebounded with 16% growth, primarily from our food service and bakery departments, and growth in our optical services and sales.

Turning to margins. Total gross margins on net merchandise sales were 14.2% for the quarter, versus 15.9% for the same period last year. As Sherry described, this decrease was from a variety of factors, including pricing actions taken to reduce inventory levels of seasonal and high cube merchandise, primarily in our non-foods categories; increased freight and handling costs; and a reduction of the premium we apply to our sales prices to offset our COVID-related operating costs.

Total revenue margins decreased 220 basis points to 15.6% of total revenues when compared to the same period last year. This revenue margin decrease is primarily attributable to the 170-basis-point decline in gross margins and a decrease of 40 basis points due to the sale of Aeropost during the first quarter.

SG&A expenses decreased during the quarter by 130 basis points as a percentage of total revenue, primarily due to the sale of Aeropost, which lowered warehouse club and other operating expenses, and general and administrative expenses, by 50 basis points each for a total of 100 basis points.

Operating income for the quarter decreased 6.3% from the same period last year to \$36.1 million.

Other expense of \$2.4 million was primarily driven by \$2 million in transaction costs associated with converting Trinidad dollars into available tradable currencies.

Our effective tax rate for the third quarter of fiscal 2022 came in higher than last year at 33.7%, versus 30.9% a year ago, with our year-to-date rate coming in at 32.8%. This increase in the quarter was primarily related to comparatively unfavorable changes and uncertain tax positions and valuation allowances on our foreign tax credits. On a go-forward basis, we continue to estimate an annualized effective tax rate of 33% to 34%.

Net income for the third quarter of fiscal 2022 was \$19.3 million, or \$0.62 per diluted share, compared to \$22.5 million, or \$0.73 per diluted share, in the comparable prior year period.

Moving on to the balance sheet, we ended the quarter with cash, cash equivalents and restricted cash totaling \$222.7 million. From a cash flow perspective, for the nine months ended May 31, 2022, cash provided by operating activities decreased \$15.7 million compared to the prior year, which was primarily a result of non-working-capital changes on the balance sheet of \$22.3

million. These changes were primarily due to prepaid expenses and income taxes, which increased due to higher sales volume, and VAT paid, which increased due to higher inventory.

Another contributor to the changing cash flow from operations was our inventory position, which increased to \$461 million as of May 31, 2022, versus \$336.6 million as of May 31, 2021. As Sherry mentioned, this was due to a combination of factors, including purchasing patterns, supply chain disruptions, inflation and the addition of three new clubs. We've taken various actions in Q3 and we're taking further actions in Q4 to continue reducing our inventory days on hand.

Net cash used in investing activities decreased by \$32.6 million for the nine months ended May 31, 2022, compared to the prior year, primarily due to the decrease in balances of our certificates of deposit compared to the same period a year ago, due to the significant improvement, or a decrease in our balance of Trinidad dollars on hand versus the prior year.

With respect to Trinidad, our balance of Trinidad-dollar-denominated cash, cash equivalents and short- and long-term investments measured in U.S. dollars improved this year, decreasing \$24.1 million from our fiscal year 2021 ending balance of \$52.9 million to approximately \$28.8 million. The \$100.3-million change from cash used in to cash provided by financing activities for the nine months ended May 31, 2022, is primarily the result of obtaining additional Trinidad-related financing in the current year, along with lower net repayments of short-term debt compared to the same nine-month period a year ago, when we were repaying short-term facilities accessed at the early stages of the COVID-19 pandemic.

In closing, although our results for the quarter were hampered by significant markdowns and freight and handling costs, we believe that the fundamentals of our business remain strong, with continued sales growth and solid membership acquisitions and renewal rates. The entire PriceSmart team continues to put in maximum effort to serve our members despite the significant challenges we face while staying true to our legacy and working to build the future. We believe our value proposition, the investments we are making in our team and technology, and how we conduct our business resonates with our members and within our communities.

So that wraps up my section. Sherry, are you ready to finish up yours, or should we move on to Q&A? Sherry, are you there? Okay. Sherry, we still don't hear you.

Sherry Bahrambeygui: All right, thank you for stepping in, Michael. I think we're now ready to go. So with regard to membership benefits, and this is where we left off, and I shared with you a little bit about private label, we are continuing with our well-being services and are seeing very positive results on the -- especially the optical and the audiology. We currently have 47 locations with optical centers and expect to have 49 open by the end of the year. This service provides the four free eye exams with every membership, and we've performed over 88,000 eye exams during the first nine months of the fiscal year, including close to 1,000 exams and eyeglasses for local schoolchildren, so we're very excited about having this service available not only for our members but to also support our local communities.

And with regard to the pharmacy centers in all eight of our warehouse clubs in Costa Rica, we

expect to have pharmacy centers in all seven of our Panamanian clubs by the end of fiscal year 2023, and we continue to analyze opening pharmacies in additional countries. And they may take different forms based on the regulatory structure, but that is something we're studying at this time.

So our third driver of growth is driving incremental sales using pricesmart.com and enhancing efficiencies and opportunities for sales using digital capabilities. And what we have right now is our total e-com sales directly represent 3.6% of total merchandise sales, and when we compare this fiscal -- third fiscal quarter versus the comparable prior year period, online sessions increased 10%, and that led to an increase of online orders of 7%. Meanwhile, the average online order value increased 14%. So we're seeing some really encouraging signs with regard to how our members are responding to their online experience with us, and pricesmart.com generally.

The digital capabilities have also been a great benefit for new member enrollment. Now, let's put this in context, because of our operating income, approximately one third or slightly above one third is represented by membership income, and the other two thirds of the net operating income is represented by the profits on our sales and services. Sales of goods and services. So when we can move the needle on increasing membership value, such that it warrants increasing membership fees, or we get more reliability in the collection of those fees, that should have a significant impact, and that's -- on our operating income.

So right now, what we're able to do, which we didn't before, is sign up our members online. And 14% of new memberships that were purchased online during the last quarter and online renewals represented 4% of our total renewals. So as of May 31, 2022, approximately 46.6% of our members have created an online profile with pricesmart.com, and that -- if you step back, we've basically gone from zero to almost half of our base having an online digital credential in less than two years. 12.5% of our total membership has made a purchase on pricesmart.com, and the average online purchase on pricesmart.com in Q3 was 31.5% higher than the average ticket for in-club purchases.

Our omnichannel members, those who shop both online and in-club, made approximately three more orders than in-club-only members during the third quarter and orders for this category of member grew 14%, with the average spend for this group growing 25% compared to the prior year fiscal third quarter. Now, we recognize that these omnichannel members historically tend to be higher-spending members anyway, so we take that into account when looking at this, but even when we compare that set of members against themselves, we're seeing growth.

Now, also encouraging is that 8% of our total membership base at 1.75 million membership accounts is enrolled in our autorenewal option, and we do have credit cards on file with many of those online autorenewal members.

We're being challenged on everything today, so I'm getting political scam calls on my phone while we're doing this conference call.

So the increase in online autorenewals with credit cards effectively takes a portion of our operating income and puts it in a much more reliable, predictable state, because that income can

be measured, and it can be extrapolated out for a period of time, at least a year, and the odds of that income being repeated for the following year is higher when you have them set up for autorenewal and you have their credit card. So that allows for a component of our income to become more reliable and more predictable, which is obviously something that is of great benefit in a climate where we're dealing with a lot of change and a lot of unpredictable variables that impact our sales. So the goal is for us to continue to increase that so that we can project out in a more reliable manner and also enhance the capture of, and reduce any leakage of the renewal of the membership fee.

Now, with regard to ESG and our commitment to sustainability, that remains strong, and despite headwinds on the horizon concerning inflation, the global economy and persistent effect of the pandemic, we're committed to fostering a healthy environment for our employees. Members, vendors, communities and the world around us are part of what we consider to be part of PriceSmart's family. The company's actions and practices aim to responsibly use natural resources and focus on environmental impact and social well-being. So for example, we've opened a recycling center in our San Pedro Sula club in Honduras and had encouraging results, and plan to have two more in Honduras by the end of the fiscal year. Now, these are centers where members of the community can bring their own recycling and actually, in some cases, get paid for the materials.

Lastly, on the subject of ESG, PriceSmart continues to invest in its relationships both with the U.S. administration and the governments of the markets that we operate in. We were a participant in the Summit of the Americas last month; had the opportunity to moderate a panel with three of the presidents of -- in three of -- three presidents of three of our markets, and we are engaging with them to make sure that we're strengthening our relationships, that there's good communication and access, and -- so that we can have a better sightline to what is going on in our markets and also make sure that those markets recognize us at the highest levels in terms of the value that we bring to those countries and those communities.

So I just want to say thank you to our teams. Especially, I want to call out buying and finance, who really shifted their focus to addressing our inventory issues so that we could address it very quickly and proactively, but we also have to recognize that logistics and operations also have been real troopers in managing the inventory in a way that we can sell it through quickly and hopefully get back to what is our normal cadence with inventory flow by the end of the fourth quarter. So I want to thank the team. I want to thank you all, and thank you for your patience with the computer glitches, and I hope you have a good day.

Questions & Answers

Operator: [Operator Instructions]

And the first question will come from Rodrigo Echagaray with Scotiabank.

Rodrigo Echagaray: Sherry and Michael, a couple of questions from my side. I want to clarify: If I understood correctly, you said that non-food categories grew in the teens in the quarter. Did I misunderstand?

Sherry Bahrambeygui: Could you --

Michael McCleary: Yes, I said 18%, yes. We grew 18%. Oops, I'm on -- sorry, I was on the wrong -- I've got some technical difficulties of my own. Yes, sorry, yes, it went up 18%.

Rodrigo Echagaray: Got it. So I guess what I'm curious to understand is, the markdowns in the context of same-store sales in the double digits, also within non-food categories, and I guess when I look at what happened in Q1 or in this -- the first half of the year, some of the retailers in the U.S. that faced some similar challenges on excess inventory, there was a much sharper slowdown on the top line, which does not appear to be there, at least not in Q3, for you guys. So is that -- how should we read that? Is that an expectation that Q4 is going to be extremely challenging?

Sherry Bahrambeygui: Rodrigo, are you referring to -- with regard to generating top line sales?

Rodrigo Echagaray: Right. So I'm trying to understand the markdowns in the context of a healthy top line, and within that, strong sales on the non-food categories, which -- it sounds like that's where you had the -- or you have the excess inventory.

Sherry Bahrambeygui: Right, right. So I -- you're perhaps trying to distinguish between the healthy sales growth and sales growth that may be just the result of markdowns below cost. Is that -- and [inaudible].

Rodrigo Echagaray: I guess -- yeah, I guess. Is that the best way to understand the dynamics in Q3 in the markdowns?

Sherry Bahrambeygui: Well, I mean, certainly one could look and say sales were impacted by the fact that merchandise was marked down significantly, but there are a number of different factors. One is our top line sales have been consistently growing. And just to give you some context, approximately 17% of our sales in Q3 were for non-foods. Of that, about two thirds of it was in hardlines and approximately one third was in softlines. And it was only with respect to a portion of the hardlines that we had this excess inventory, and I think -- Michael, have you quantified that as of the end of May, the amount of excess inventory or what we deem to be excess in the hardlines? Is that --

Michael McCleary: Yes, we're -- yes. We've increased our days-on-hand targets because of all the supply chain complexities, but when you carve that out, we're estimating that we're probably about \$20 million to \$30 million higher than we would like to be in general, as of the end of Q3, between hardlines and softlines.

But I think, to your question about markdowns and does that signal a slowdown, I mean, we did -
- Sherry did share the June comps, right? The 11.8%. So you do have an indicator of the direction of sales, that sales are headed, at least for the first month of the quarter, and also -- I think Sherry has also emphasized that we've really been trying to clear out this problem, and that doesn't necessarily mean that there's going to be a slowdown; we're just trying to work through

some of the backlog that we have with overlapping programs, and most importantly, just cleaning things up so that when the red and green starts hitting at the beginning of the fiscal year, that we have space for it and we're out of this stuff that's kind of accumulated, so I don't think we're directly linking markdowns to a slowdown in growth at this point. I mean, obviously at some point the higher-ticket items have some inflation impact, but -- and we're especially focused on those. The current quarter, we're working on the furniture program, which has some higher-ticket items, and we have to keep an eye on those, but we're not directly projecting a slowdown at this point.

Sherry Bahrambeygui: Now, to fill that in a bit, Rodrigo, if your question is with regard to the excess inventory, I'd reiterate what Michael's saying, is we don't see the excess inventory as being a cause for a slowdown. There are other factors our business is facing, I mean -- and we can't really predict, other than FX is providing major headwinds. Colombia's FX, Costa Rica's FX. Whether or not that results in a slowdown remains to be seen. I mean, we have been operating with significant FX headwinds more so than historically, I think, for a couple of years now, and we're managed to continue to grow sales.

So clearly, we have to continue doing what we do best, and we know we're in tough markets with currencies that fluctuate and, at least more recently, over the past few years, don't fluctuate in our favor very often, but we're still delivering sales growth and healthy comps, and that is through all the -- a multitude of decisions we make along the way in order to achieve those sales. So I can't answer -- I couldn't answer to you whether or not there will be a slowdown because again, there are so many factors that are beyond our control. All I can tell you is that we're very conscious of them and we're trying to make the right business decision every day to be able to keep the members happy, keep the memberships renewing, grow the membership base and generate those sales.

Rodrigo Echagaray: Got it. And so I guess maybe a better way to ask that same question is, would it be fair to say that the expectations were much higher for certain hardlines in terms of top line for Q3, and that's where the excess inventory came from, just on the expectations front, rather than weakness on the top line in terms of customers really adapting?

Sherry Bahrambeygui: We -- yes. To the extent we're not clear about it, there's no doubt -- I mean, when we were making -- remember, these hardlines usually have long lead times, and the decisions regarding consumer preferences and what we anticipate the market will demand are made nine months, six months, nine months, 12 months in advance of the time that the consumer will actually be in a position to transact. So in an environment where things are shifting pretty significantly back and forth, we did take a point of view. And we took a point of view that we are going to make a strategic investment in more inventory with the expectation that we would be able to capture higher sales and be able to sell these items.

After that is really when a number of these other factors came together and sort of created a perfect storm, even though some of it was ongoing. But we saw the Asia port closures increasing more extensively. What would happen is we'd have merchandise there, ready to go; it was seasonal; no one was there to put it on the ship to send it to us. But then we'd have the next season coming up on the heels of the prior season's merchandise and by the time the first season

got to the clubs, it was almost -- it almost ran out of time in the schedule. So we'd have two rotational seasons backed up. That's the kind of challenge that we didn't -- we couldn't predict. It was caused, again, by the supply chain disruption, the unexpected closures, the unavailability of containers. But that's what we were faced with at a time when we basically took a point of view that we want to have the in-stocks, and we want to push for the sales. Now as it turns out, looking back, had we known all these other things would happen as well, we probably wouldn't have taken that same point of view. Does that help?

Rodrigo Echagaray: No, that makes sense. Yes, no, for sure. I think I get it. It makes sense.

Sherry Bahrambeygui: And this is why -- yes, I think it's important to recognize, again, we're not happy about it, but it's a point in time. It's a point in time where these different variables came together and resulted in the current situation with excess inventory, and we are, as a result, addressing it directly and as quickly as we can to get back on track, and we don't see it as a development that should continue on an ongoing basis or something that we have an issue with in terms of our ordinary course of business and how we do business and make decisions.

Rodrigo Echagaray: Got it. No, that makes sense. And just another question to clarify: If I understood correctly, the expectation is that, roughly speaking, the impact on consolidated gross margins in Q4 is upwards to 50 bps just on the excess inventory issue, if I understood correctly.

Sherry Bahrambeygui: We're estimating within a range of 25 to 50 basis points to account for the rest of the merchandise that has not yet been sold and the compression on that merchandise that's not already been accounted for in your Q3 numbers, in our Q3 numbers, which you see. And that's -- the residual of that would be about 25 to 50 basis points, which, again, we've got to have more sales information in terms of trends, but we think we should be out by the end of Q4.

Rodrigo Echagaray: Got it. And given that we have these short-term challenges, and then also when we include the excess margin that came from [inaudible] that is, I guess, not normalizing, or should normalize, like, when we look at the gross margins over time, what should be the reasonable gross margin expectation for the future? And I know you don't give guidance. I'm not looking for guidance. But I guess I'm trying to understand what's the -- where do you feel comfortable in terms of gross margins given those two issues that are kind of impacting the visibility on the gross margins?

Sherry Bahrambeygui: This is an area that we -- comes up over and over again, and I personally have wondered how someone in your position can rely solely on a gross margin percentage, because knowing what we know about how our business operates and how it's evolved -- I think we talked about this before.

Historically, almost all of our sales were the result of purchasing merchandise, marking it up, getting it to the clubs and selling it. As a business, we've intentionally evolved and have developed new capabilities and have expanded ways that we think we can either create greater value or create efficiencies, and as a result, we've got more than just purchasing items and then getting them to the clubs.

And the examples are the produce distribution center. I mean, I'm sorry, our farm program, direct farm program. We've invested our own people in identifying and teaching farmers food safety and helping identify what they need to be able to provide a reliable source of produce to a company like ours. We've invested in a produce distribution center. We've invested in teaching them food safety and handling. That is more like getting involved and actually creating a business that then supplies us. And as a result, the margin structure on that program is different. It's higher. But we only will do something like that if we feel ultimately the product that comes from that is going to be as good, if not better, quality and a better price for the member. And in that circumstance -- and will still remain very competitive and maintain our typical comp umbrella. So in that circumstance, you're going to see a higher margin percentage that's applied to that specific function. That example --

Rodrigo Echagaray: Yes. No, that makes sense. Efficiencies that were not there before should be accounted for, but tough to put a number around that. But I guess I'm -- I do have a good perspective with these comments in that you're not necessarily going back for the 16% range, necessarily, makes sense just because that used to be the gross margin, especially after these investments have been made.

Sherry Bahrambeygui: But in some cases, in some cases, the gross margin may be higher in certain [inaudible] of our business. So for example, private label. As we're expanding private label, what we're really doing is we're getting more involved in product development ourselves. That requires more expertise. It's more investment on our part. It's more involvement further up in the supply chain. Once again, that would, in some cases, merit a different margin structure. But the bottom line is, we have to always tie it back to, are we giving the greatest value we can to the member? Do we have a healthy comp umbrella? Have we squeezed out the inefficiencies? And all eyes are on that effort, but we recognize that when we have to participate so much more than just identifying the merchandise and then -- and getting it to the clubs, that the shareholders must have a return on the investment that it requires from us to be able to create that opportunity and make it available.

Rodrigo Echagaray: Got it. I took a lot of your time. Thank you so much.

Sherry Bahrambeygui: Our pleasure. Thank you. And congratulations, Rodrigo.

Rodrigo Echagaray: Oh, thank you. Thanks, Sherry.

Operator: That is all the time we have for today's call. I would now like to turn the call back over to management for any closing remarks.

Sherry Bahrambeygui: We do not have -- oops. Can you hear me?

Operator: Yes, ma'am.

Sherry Bahrambeygui: Okay. We want to thank our shareholders and our employees for continuing to stand strong with us as we navigate some choppy waters, but again, this was a limited-time, limited-scope situation in our view, and our focus is -- remain -- our focus remains

on the medium-term and long-term growth of the company and continuing to invest in that and make sure that we are doing our best for the future. So thank you for being with us today.

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