Williams Partners L.P.
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The following is a press release issued by The Williams Companies, Inc. on July 30, 2014 announcing its financial results for the quarter ended June 30, 2014.

DATE: July 30, 2014

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Williams Reports Second-Quarter 2014 Financial Results

Expected 2Q 2014 Cash Distributions From Williams Partners and Access Midstream Partners Totals $509 Million, Up 29% vs. 2Q 2013

Adjusted Segment Profit + DD&A Is $742 Million, Up 15% vs. 2Q 2013

Adjusted Income Is $158 Million or $0.23 per Share, Up 22% vs. 2Q 2013

2Q 2014 Net Income Is $103 Million or $0.15 per Share

Updating Financial Guidance Primarily to Reflect Acquisition of Additional Interests in Access Midstream Partners

Affirming Planned Dividend Guidance: 3Q 2014 Up 32% to $0.56, or $2.24 on an Annualized Basis; $2.46 in 2015, With Follow-On Annual Dividend Growth of Approximately 15% through 2017

Williams Partners and Access Midstream Partners Evaluating Merger as Proposed by Williams

Summary Financial Information	**2Q**		**YTD**	
Amounts in millions, except per-share amounts. Per share amounts are reported on a diluted basis. All amounts are attributable to The Williams Companies, Inc.	2014	2013	2014	2013
(Unaudited)				
Partnership Cash Distributions to Williams				
Williams Partners (1)	$ 431	$ 373	$ 853	$ 732
Access Midstream Partners (1)	78	22	111	$ 44
Total	$ 509	$ 395	$ 964	$ 776

Adjusted segment profit + DD&A (2)	$ 742	$ 644	$ 1,538	$ 1,343
Adjusted income from continuing operations (2)	$ 158	$ 129	$ 348	$ 281
Adjusted income from continuing operations per share (2)	$ 0.23	$ 0.19	$ 0.50	$ 0.41
Net income	$ 103	$ 142	$ 243	$ 303
Net income per share	$ 0.15	$ 0.21	$ 0.35	$ 0.44

(1) *The quarterly cash distributions in this table are declared and received in the following quarter.*

(2) *Schedules reconciling segment profit to adjusted segment profit + DD&A and income from continuing operations to adjusted income from continuing operations (non-GAAP measures) are available at www.williams.com and as an attachment to this news release.*

TULSA, Okla. Williams (NYSE: WMB) today announced second-quarter 2014 cash distributions from Williams Partners and Access Midstream Partners of $509 million, a $114 million, or 29 percent, increase from total cash distributions received for second-quarter 2013. The quarterly cash distributions discussed in this release are declared and received in the following quarter, as these distributions relate to the prior quarter s cash flow.

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Year-to-date 2014, Williams reported cash distributions from Williams Partners and Access Midstream Partners of $964 million, a $188 million, or 24 percent increase from the same period last year.

For second-quarter 2014, Williams reported $742 million in adjusted segment profit + DD&A, compared with $644 million in adjusted segment profit + DD&A in second-quarter 2013. The $98 million increase in second-quarter adjusted segment profit + DD&A for the quarter was driven by a $100 million increase in adjusted segment profit + DD&A for Williams Partners. The Williams Partners increase included $46 million, or 7 percent, growth in fee-based revenues compared with second-quarter 2013, as well as $52 million in higher Geismar results, partially offset by lower NGL margins. The Geismar plant remained off-line for the quarter; however, assumed business interruption insurance proceeds for the second quarter totaled $138 million and were included in the calculation of adjusted segment profit + DD&A.

Year-to-date adjusted segment profit + DD&A was $1.538 billion, compared with $1.343 billion year-to-date 2013. The $195 million increase in year-to-date adjusted segment profit + DD&A was driven by a $187 million increase in adjusted segment profit + DD&A for Williams Partners. The Williams Partners increase includes $109 million, or 8 percent, growth in fee-based revenues compared with the year-to-date 2013 period, as well as $113 million in higher Geismar results, which include the favorable impacts of the assumed business interruption insurance proceeds.

Adjusted income from continuing operations for second-quarter 2014 was $158 million, or $0.23 per share, compared with $129 million, or $0.19 per share for second-quarter 2013. Year-to-date through June 30, adjusted income from continuing operations was $348 million, or $0.50 per share, compared with $281 million, or $0.41 per share, for the first six months of 2013.

The increases in adjusted income for the quarter were driven by the growth in Williams Partners fee-based revenues, as well as higher adjusted Geismar results (including the benefit of assumed business interruption insurance recoveries), partially offset by lower NGL margins and higher net interest expense and income tax expense. The increases in adjusted income for the year-to-date period were driven by similar factors that drove the quarterly comparison.

Adjusted income from continuing operations and adjusted segment profit + DD&A are non-GAAP measures and reflect the removal of items considered unrepresentative of ongoing operations and may include assumed business interruption insurance related to the Geismar plant. Reconciliations to the most relevant GAAP measures are attached to this news release.

Williams reported unaudited second-quarter 2014 net income attributable to Williams of $103 million, or $0.15 per share on a diluted basis, compared with net income of $142 million, or $0.21 per share on a diluted basis, for second-quarter 2013.

The decline in net income during second-quarter 2014 was driven by lower NGL and olefin margins, as well as $36 million higher net interest expense associated with recent debt issuances, partially offset by increased fee-based revenues and lower income tax expense.

For the first half of 2014, Williams reported net income of $243 million, or $0.35 per share on a diluted basis, compared with net income of $303 million, or $0.44 per share, for the same time period in 2013.

The decline in net income for the first half of 2014 was primarily due to $95 million of first-quarter 2014 charges related to the proposed Bluegrass Pipeline project, as well as $48 million higher net interest expense. Lower NGL and olefin margins were partially offset by higher fee-based revenues and insurance recoveries related to the Geismar incident.

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CEO Comment

Alan Armstrong, Williams president and chief executive officer, made the following comments:

We re pleased to report that Williams benefited from a 29-percent increase in second-quarter cash distributions from our two MLP investments compared with second-quarter 2013 due to the continued rapid growth in cash flows of Williams Partners and Access Midstream Partners.

Our recent acquisition of significant additional interests in Access Midstream Partners, which has extensive natural gas gathering systems in attractive growth basins, is expected to further enhance our presence in key regions and deliver immediate and future dividend growth for Williams shareholders. We expect the acquisition will also reinforce Williams stable, fee-based business model and support our industry-leading dividend growth strategy.

Our proposal to merge Williams Partners and Access Midstream Partners would create the fastest-growing, large midstream MLP that will generate competitively advantaged investment opportunities for decades to come as we connect the best shale basins to the best markets.

Business Segment Results

Williams business segments for financial reporting are Williams Partners, Access Midstream Partners, Williams NGL & Petchem Services and Other.

The Williams Partners segment includes the consolidated results of Williams Partners L.P. (NYSE: WPZ). Prior to July 1, 2014, Access Midstream Partners included the company s equity earnings from its 50-percent interest in privately held Access Midstream Partners GP, L.L.C. and an approximate 23-percent limited-partner interest in Access Midstream Partners, L.P. (NYSE: ACMP). As a result of our acquisition of additional ownership interests, periods after July 1, 2014 will include the consolidated results of Access Midstream Partners. Following the dropdown of Williams currently operational Canadian assets to Williams Partners in February 2014, Williams NGL & Petchem Services segment is comprised of various developmental-stage projects. Prior period segment results have been recast to reflect our contribution of certain Canadian assets to Williams Partners.

Williams *Amounts in millions (loss)*	**2Q - 2014** Segment Profit	Adj.**	Adj. Segment Profit*	Adj. Segment Profit + DD&A*	**2Q - 2013** Segment Profit	Adj.**	Adj. Segment Profit*	Adj. Segment Profit + DD&A*
Williams Partners	$ 393	$ 119	$ 512	$ 719	$ 427	$ 1	$ 428	$ 619
Access Midstream Partners	9	(2)	7	22	29	(26)	3	18
Williams NGL & Petchem	(8)	1	(7)	(6)	(1)	0	(1)	(1)
Other	1	0	1	7	1	0	1	8
Total	$ 395	$ 118	$ 513	$ 742	$ 456	($ 25)	$ 431	$ 644

	YTD - 2014 Segment Profit	Adj.**	Adj. Segment Profit*	Adj. Segment Profit + DD&A*	**YTD - 2013** Segment Profit	Adj.**	Adj. Segment Profit*	Adj. Segment Profit + DD&A*
Williams Partners	$ 896	$ 179	$ 1,075	$ 1,490	$ 921	($ 5)	$ 916	$ 1,303
Access Midstream Partners	15	(2)	13	43	29	(26)	3	35
Williams NGL & Petchem	(108)	96	(12)	(11)	(3)	0	(3)	(3)
Other	4	0	4	16	(4)	0	(4)	8
Total	$ 807	$ 273	$ 1,080	$ 1,538	$ 943	($ 31)	$ 912	$ 1,343

* *Schedules reconciling segment profit to adjusted segment profit and adjusted segment profit + DD&A are attached to this news release.*

** *Adjustments for Williams Partners second-quarter and year-to-date 2014 periods consist primarily of assumed business interruption insurance related to the Geismar plant. Second quarter assumed $138 million of business interruption insurance offset by actual insurance recoveries of $50 million. Year-to-date assumes $311 million of business interruption insurance offset by actual insurance recoveries of $175 million. Adjustments to Williams NGL & Petchem Services for year-to-date 2014 consist primarily of $96 million in charges related to the proposed Bluegrass Pipeline project.*

Williams Partners

Williams Partners is focused on natural gas transportation, gathering, treating, processing and storage; natural gas liquids fractionation; olefins production; and oil transportation.

Williams received regular quarterly cash distributions of $422 million from Williams Partners L.P. during second-quarter 2014 and is expected to receive distributions totaling $431 million in August. There is a more detailed description of Williams Partners business results in the partnership s second-quarter 2014 financial results news release, also issued today.

For second-quarter 2014, Williams Partners reported adjusted segment profit + DD&A of $719 million, compared with $619 million for second-quarter 2013.

The increase in second-quarter adjusted segment profit +DD&A was primarily due to $52 million in higher Geismar results. The Geismar plant remained off-line for the quarter; however, assumed business interruption insurance proceeds for the second quarter totaled $138 million and were included in the calculation of adjusted segment profit +

DD&A. Fee-based revenues increased $46 million, or 7 percent, in second-quarter 2014 compared with the year-ago period. Additionally, the 2014 period was unfavorably affected by $23 million lower NGL margins.

Year-to-date through June 30, Williams Partners reported $1.490 billion in adjusted segment profit + DD&A, compared with $1.303 billion for the same period in 2013.

For the first half of 2014, the Williams Partners increase includes $109 million, or 8 percent, growth in fee-based revenues compared with the year-to-date 2013 period, as well as $113 million in higher Geismar results, which include the favorable impacts of the assumed business interruption insurance proceeds.

Access Midstream Partners

Access Midstream Partners reported adjusted segment profit + DD&A of $22 million compared with $18 million for second-quarter 2013. Williams received a regular quarterly distribution of $33 million from Access Midstream Partners during second-quarter 2014 and is expected to receive distributions totaling $78 million in August.

Year-to-date 2014, Access Midstream Partners reported adjusted segment profit + DD&A of $43 million compared with $35 million for year-to-date 2013. Year-to-date 2014, Williams has received total cash distributions of $64 million from Access Midstream Partners.

Williams NGL & Petchem Services

As previously mentioned, following the dropdown of Williams currently operational Canadian assets to Williams Partners in February 2014, Williams NGL & Petchem Services segment is comprised of various developmental-stage projects in Canada and the Gulf Coast.

Williams NGL & Petchem Services reported adjusted segment loss + DD&A of $6 million for second-quarter 2014, compared with a loss of $1 million for second-quarter 2013.

For the first half of 2014, Williams NGL & Petchem Services reported adjusted segment loss +DD&A of $11 million, compared with a loss of $3 million for the first half of 2013.

Guidance

Williams is affirming previously announced dividend guidance as follows: Increase its third-quarter 2014 dividend 32 percent to $0.56, or $2.24 on an annualized basis. In addition to the third-quarter 2014 dividend increase, Williams also is affirming dividend-growth guidance of approximately 15 percent annually from the higher third-quarter 2014 base through 2017 with planned dividends of approximately $1.96 in 2014, $2.46 in 2015, $2.82 in 2016, and $3.25 in 2017. The expected quarterly increases in Williams dividend are subject to quarterly approval of the company s board of directors.

As a result of Williams acquisition of additional ownership interests, the Access Midstream Partners segment will include the consolidated results of Access Midstream Partners for periods after July 1, 2014. Williams has adjusted its financial guidance to reflect the additional ownership in Access Midstream Partners as well as the related consolidation due to the acquisition effective on July 1, 2014 for purposes of financial reporting. Williams expects to complete its preliminary accounting allocation of the purchase price for the additional interests of Access Midstream Partnership during the third quarter of 2014. As a result of the accounting method change from the equity-method to consolidation, in the third quarter Williams expects to recognize a significant non-cash gain, currently estimated to be in the range of $2.5 billion to $3 billion, related to the required revaluation of its December 2012 investment in Access Midstream Partners. Additionally, Williams expects to record a substantially higher level of depreciation and amortization expense than currently reflected by Access Midstream Partners associated with Williams increased basis in Access Midstream Partners.

Williams Partners is lowering its earnings and cash flow guidance and revising its capital spending guidance for 2014 as a result of delays in Geismar s expected in-service date. Williams Partners consolidated earnings, cash flow and capital expenditures guidance for 2015 and 2016 are unchanged.

Williams Partners expects adjusted profit + DD&A to grow by more than 68 percent for the period 2016 versus 2013. Several key drivers and assumptions are embedded in this estimate. The largest risks to achieving this growth in 2014 are:

a. The timely producer startup of the Gulfstar One project and Discovery s Keathley Canyon project.

b. The completion and commissioning of new facilities in the Marcellus producing region along with expected volume growth.

c. Natural gas and natural gas liquids prices that drive assumed NGL margins and drilling activities, as well as olefins prices and margins.

d. Recovery of assumed business interruption insurance proceeds relating to the Geismar plant outage in 2014.

e. Geismar restart and ethylene sales commencing in the fourth-quarter 2014.

The Geismar rebuild and expansion projects are now substantially complete and the start-up process is planned to be initiated in September following the installation of certain safety equipment. Williams Partners is taking these extra precautions to enhance the safety of our people and the public. Williams Partners is targeting first ethylene production and sales in October; however, start-up issues could cause delays. As a result, financial guidance now includes a range of outcomes for first ethylene production and sales ranging from mid-October to the end of December 2014. The delay from the previous expectation of ethylene sales resulted from the recent decision to install certain safety-related equipment and to provide additional contingency associated with the startup process. The Geismar rebuild project capital is expected to increase by approximately $20 million as a result of the safety modifications.

Williams Partners has $500 million of combined business interruption and property damage insurance related to the Geismar incident (subject to deductibles and other limitations). Risks associated with the expected full recovery of $500 million in insurance proceeds related to the Geismar incident could result in full-year 2014 distributable cash flow that is below the guidance range. In the second quarter, the insurers paid $50 million of the most recent claim-payment request of $200 million and the total insurance receipts to-date are $225 million. The insurers continue to evaluate Williams Partners claims and have recently raised questions around key assumptions involving our business-interruption claim. As a result, the insurers have elected to make a partial payment pending further assessment of these issues. Williams Partners continues to work with insurers in support of all claims, as submitted, and is vigorously pursuing collection of the remaining $275 million insurance limits.

The assumed expanded plant restart date and repair cost estimate are subject to various uncertainties and risks that could cause the actual results to be materially different from these assumptions. The assumed property damage and business interruption insurance proceeds are also subject to various uncertainties and risks that could cause the actual results to be materially different from these assumptions.

Capital expenditures for Williams included in guidance for 2014 through 2016 were increased by approximately $2.55 billion to reflect the consolidation of Access Midstream Partners. Additionally, capital expenditures have been decreased by approximately $565 million to reflect a shift in capital spending to periods beyond 2016 for developing Canadian projects in the Williams NGL & Petchem Services segment. Capital spending for Williams Partners increased in 2014 as a result of the Geismar expansion project.

Williams current guidance is displayed in the following table:

Williams Guidance	**2014**	**2015**	**2016**
Dollars in millions			
Partnership Cash Distributions to Williams			
Williams Partners (1)	$ 1,775	$ 2,007	$ 2,283
Access Midstream Partners (1)	$ 288	$ 481	$ 613
Total	2,063	2,488	2,896
Other Items - net (2)	(336)	(242)	(371)
Cash Flow Available for Dividends	$ 1,727	$ 2,246	$ 2,525
Dividends	(1,440)	(1,851)	(2,134)
Cash Flow Available After Dividends	$ 287	$ 395	$ 391
Dividends Per Share (3)	$ 1.96	$ 2.46	$ 2.82
Coverage Ratio (4)	1.20x	1.21x	1.18x
Capital & Investment Expenditures			
Williams Partners	$ 3,730	$ 2,450	$ 2,280
Access Midstream Partners	$ 640	$ 1,080	$ 830
Williams NGL & Petchem Services	455	75	320
Other	55	40	40
Total Capital & Investment Expenditures	$ 4,880	$ 3,645	$ 3,470

(1) The quarterly cash distributions included in this table are declared and received in the following quarter.
(2) Includes corporate interest, cash taxes and capex partially offset by cash flows from Williams NGL & Petchem Services segment. Additional detail related to these items is available in the quarterly data book at www.williams.com
(3) Dividend per-share guidance for 2017 is $3.25.
(4) Cash flow available for Dividends / Dividends.

Second-Quarter 2014 Materials to be Posted Shortly; Q&A Webcast Scheduled for Tomorrow

Williams second-quarter 2014 financial results package will be posted shortly at www.williams.com. The package will include the data book and analyst package.

Williams and Williams Partners L.P. will host a joint Q&A live webcast on Thursday, July 31, at 9:30 a.m. EDT. A limited number of phone lines will be available at (800) 479-9001. International callers should dial (719) 325-2199. A link to the webcast, as well as replays of the webcast in both streaming and downloadable podcast formats, will be available for two weeks following the event at www.williams.com and www.williamslp.com.

Form 10-Q

The company plans to file its second-quarter 2014 Form 10-Q with the Securities and Exchange Commission this week. Once filed, the document will be available on both the SEC and Williams websites.

Non-GAAP Measures

This press release includes certain financial measures adjusted segment profit, adjusted segment profit + DD&A, adjusted income from continuing operations (earnings) and adjusted earnings per share that are non-GAAP financial measures as defined under the rules of the Securities and Exchange Commission. Adjusted segment profit, adjusted earnings and adjusted earnings per share measures exclude items of income or loss that the company characterizes as unrepresentative of its ongoing operations and may include assumed business interruption insurance related to the Geismar plant. Management believes these measures provide investors meaningful insight into the company s results from ongoing operations.

This press release is accompanied by a reconciliation of these non-GAAP financial measures to their nearest GAAP financial measures. Management uses these financial measures because they are widely accepted financial indicators used by investors to compare a company s performance. In addition, management believes that these measures provide investors an enhanced perspective of the operating performance of the company and aid investor understanding. Neither adjusted segment profit, adjusted segment profit + DD&A, adjusted earnings, nor adjusted earnings per share measures are intended to represent an alternative to segment profit, net income or earnings per share. They should not be considered in isolation or as substitutes for a measure of performance prepared in accordance with United States generally accepted accounting principles.

About Williams (NYSE:WMB)

Williams, headquartered in Tulsa, Okla., is one of the leading energy infrastructure companies in North America. It owns controlling interests in both Williams Partners L.P. (NYSE:WPZ) and Access Midstream Partners, L.P. (NYSE:ACMP) through its ownership of 100 percent of the general partner of each partnership. Additionally, Williams owns approximately 66 percent and 50 percent of the limited partner units of Williams Partners L.P. and Access Midstream Partners, L.P., respectively.

Williams Partners L.P. owns and operates both on-shore and offshore assets of approximately 15,000 miles of natural gas gathering and transmission pipelines, 1,800 miles of NGL transportation pipelines, an additional 11,000 miles of oil and gas gathering pipelines and numerous other energy infrastructure assets. The partnership s facilities have daily gas processing capacity of 6.6 billion cubic feet of natural gas, NGL production of more than 200,000 barrels per day and domestic olefins production capacity of 1.35 billion pounds of ethylene and 90 million pounds of propylene per year.

Access Midstream Partners, L.P. owns, operates, develops and acquires natural gas gathering systems and other midstream energy assets. Headquartered in Oklahoma City, the partnership s operations are focused on the Barnett, Eagle Ford, Haynesville, Marcellus, Niobrara and Utica Shales and the Mid-Continent region of the U.S.

For more information about Williams, Williams Partners and Access Midstream Partners, visit www.williams.com, www.williamslp.com and www.accessmidstream.com.

Certain matters contained in this document include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements relate to anticipated financial performance, management s plans and objectives for future operations, business prospects, outcome of regulatory proceedings, market conditions and other matters. We make these forward-looking statements in reliance on the safe harbor protections provided under the Private Securities Litigation Reform Act of 1995.

All statements, other than statements of historical facts, included in this document that address activities, events or developments that we expect, believe or anticipate will exist or may occur in the future, are forward-looking statements. Forward-looking statements can be identified by various forms of words such as anticipates, believes, seeks, could, may, should, continues, estimates, expects, forecasts, intends, might, proposed, planned, potential, projects, scheduled, will, assumes, guidance, outlook, in service date or other si These forward-looking statements are based on management s beliefs and assumptions and on information currently available to management and include, among others, statements regarding:

The levels of dividends to stockholders;

Expected levels of cash distributions by Access Midstream Partners, L.P. (ACMP) and Williams Partners L.P. (WPZ) with respect to general partner interests, incentive distribution rights, and limited partner interests;

Amounts and nature of future capital expenditures;

Expansion and growth of our business and operations;

Financial condition and liquidity;

Business strategy;

Cash flow from operations or results of operations;

Seasonality of certain business components;

Natural gas, natural gas liquids and olefins prices, supply and demand;

Demand for our services; and

The proposed merger of ACMP and WPZ (the Proposed Merger).

Forward-looking statements are based on numerous assumptions, uncertainties and risks that could cause future events or results to be materially different from those stated or implied in this document. Many of the factors that will determine these results are beyond our ability to control or predict. Specific factors that could cause actual results to differ from results contemplated by the forward-looking statements include, among others, the following:

Whether WPZ, ACMP, or the merged partnership will produce sufficient cash flows to provide the level of cash distributions we expect;

The structure, terms, timing and approval of the Proposed Merger, as to be negotiated by the conflicts committees of ACMP and WPZ;

Whether we are able to pay current and expected levels of dividends;

Availability of supplies, market demand and volatility of prices;

Inflation, interest rates, fluctuation in foreign exchange rates, and general economic conditions (including future disruptions and volatility in the global credit markets and the impact of these events on customers and suppliers);

The strength and financial resources of our competitors and the effects of competition;

Whether we are able to successfully identify, evaluate and execute investment opportunities;

Our ability to acquire new businesses and assets and successfully integrate those operations and assets, including ACMP s business, into our existing businesses, as well as successfully expand facilities;

Development of alternative energy sources;

The impact of operational and development hazards and unforeseen interruptions;

Costs of, changes in, or the results of laws, government regulations (including safety and environmental regulations), environmental liabilities, litigation, and rate proceedings;

Our costs and funding obligations for defined benefit pension plans and other postretirement benefit plans;

Changes in maintenance and construction costs;

Changes in the current geopolitical situation;

Our exposure to the credit risk of customers and counterparties;

Risks related to strategy and financing, including restrictions stemming from debt agreements, future changes in credit ratings and the availability and cost of capital;

The amount of cash distributions from and capital requirements of our investments and joint ventures in which we participate;

Risks associated with weather and natural phenomena, including climate conditions;

Acts of terrorism, including cybersecurity threats and related disruptions; and

Additional risks described in our filings with the Securities and Exchange Commission.

Given the uncertainties and risk factors that could cause our actual results to differ materially from those contained in any forward-looking statement, we caution investors not to unduly rely on our forward-looking statements. We disclaim any obligations to and do not intend to update the above list or to announce publicly the result of any revisions to any of the forward-looking statements to reflect future events or developments.

In addition to causing our actual results to differ, the factors listed above may cause our intentions to change from those statements of intention set forth in this announcement. Such changes in our intentions may also cause our results to differ. We may change our intentions, at any time and without notice, based upon changes in such factors, our assumptions, or otherwise.

Because forward-looking statements involve risks and uncertainties, we caution that there are important factors, in addition to those listed above, that may cause actual results to differ materially from those contained in the forward-looking statements. For a detailed discussion of those factors, see Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2013, and Part II, Item 1A. Risk Factors of our Forms 10-Q.

Important Additional Information

This document does not constitute an offer to buy or solicitation of an offer to sell any securities. This document contains information related to a proposal which The Williams Companies, Inc. has made for a business combination transaction of Williams Partners L.P. (WPZ) and Access Midstream Partners, L.P. (ACMP). In furtherance of this proposal and subject to future developments, ACMP may file a registration statement with the SEC. INVESTORS ARE URGED TO READ THE REGISTRATION STATEMENT AND OTHER DOCUMENTS FILED WITH THE SEC CAREFULLY IN THEIR ENTIRETY IF AND WHEN THEY BECOME AVAILABLE AS THEY WILL CONTAIN IMPORTANT INFORMATION. Investors and security holders will be able to obtain free copies of these documents (if and when available) and other documents filed with the SEC by WPZ or ACMP through the website maintained by the SEC at http://www.sec.gov.

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Reconciliation of Income (Loss) from Continuing Operations Attributable to The Williams Companies, Inc. to Adjusted Income

(UNAUDITED)

	2013					2014		
(Dollars in millions, except per-share amounts)	*1st Qtr*	*2nd Qtr*	*3rd Qtr*	*4th Qtr*	*Year*	*1st Qtr*	*2nd Qtr*	*Year*
Income (loss) from continuing operations attributable to The Williams Companies, Inc. available to common stockholders	$ 162	$ 149	$ 143	$ (13)	$ 441	$ 140	$ 99	$ 239
Income (loss) from continuing operations - diluted earnings per common share	$ .23	$ .22	$ .20	$ (.02)	$ .64	$ .20	$ .14	$ .34
Adjustments:								

The closing price of our common stock on December 16, 2004 was $8.35.

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THE RIGHTS OFFERING

General

As soon as practicable, we will distribute to each holder of our common stock, at no charge, one transferable subscription right for each share of our common stock owned by such holder as of the close of business on the record date. The rights will be evidenced by rights certificates.

Each right entitles its holder to purchase: (i) for a period of one month, 1.5 shares of our common stock for each share of common stock they own as of the November 24, 2004, at a price of $7 per share; and (ii) for a period of eleven months beginning after the one month period referred to in part (i) above expires, 1.5 shares of common stock for each share of common stock they own as of November 24, 2004, at a price of $8 per share. If a rights holder exercises a right at a subscription price of $7, such rights holder may not also exercise that right at a subscription price of $8. Therefore, in total, stockholders will only receive sufficient rights to enable them to purchase 1.5 shares of common stock for each share they own as of November 24, 2004, regardless of when they exercise their rights. If a right is subscribed at $7, the subscription price would reflect an approximately 20% discount to the $8.80 per share last sales price of our common stock on the Nasdaq National Market on September 3, 2004, the last trading day before the announcement of the subscription prices. Rights holders will not have the right to subscribe for shares not purchased by rights holders who hold rights at the expiration of the $8 subscription period and elect not to exercise their rights.

The following describes the rights offering in general and assumes (unless specifically provided otherwise) that you are a record holder of our common stock. If you hold your shares of our common stock in a brokerage account or through a dealer or other nominee, please see the information included below under the heading Beneficial Owners. As used in this prospectus and in the related instructions for completing rights certificates, the term business day means any day on which securities may be traded on the Nasdaq National Market.

Reasons for the Rights Offering

As previously disclosed in our Current Report on Form 8-K filed with the SEC on November 4, 2004, we have begun implementing a transaction designed to improve our profitability by reducing our interest payments and eliminating our preferred stock dividend obligations. As of the date of this prospectus, substantially all of the common stock issuable to our affiliates pursuant to such transaction has been issued. The purposes of this rights offering are to provide holders of our common stock not affiliated with us or the Prices, an opportunity to further invest in us and maintain a portion, if not all, of their proportionate interest in our common stock at a lower price per share than was offered to the Prices in connection with our exchange of common stock for obligations owed by us to the Prices and for shares of preferred stock held by the Prices, as described below, and to allow us to obtain long-term financing through an equity offering to our common stockholders. On October 29, 2004, we held a special meeting of stockholders to approve elements of the transaction as required by Nasdaq Marketplace Rules and the Delaware General Corporation Law. The transaction includes the following elements, each of which was approved by our common stockholders at the special meeting:

- a private placement of 3,164,726 shares of our common stock, at a price of $8 per share, to The Price Group to be funded through the conversion of a $25.0 million bridge loan, together with accrued and unpaid interest, extended to us by The Price Group on August 31, 2004;

- an issuance of an aggregate of 2,200,000 shares of our common stock to the Sol and Helen Price Trust, the Price Family Charitable Fund, the Robert and Allison Price Charitable Remainder Trust, the Robert and Allison Price Trust 1/10/75 and The Price Group in exchange for all of the outstanding shares of our 8% Series B Cumulative Convertible Redeemable Preferred Stock, par value $.0001 per share;

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an issuance of 2,597,200 shares of our common stock, valued for such purpose at a price of $8 per share, to The Price Group in exchange for up to $20.0 million of current obligations, plus accrued and unpaid interest, we owed to The Price Group;

an issuance of up to 16,052,668 shares of our common stock in connection with the rights offering described herein;

an issuance of up to 3,125,000 shares of our common stock, at a price of $8 per share, to The Price Group to ensure that this rights offering generates at least $25.0 million in proceeds;

an issuance of up to 2,223,104 shares of our common stock associated with an offer to exchange common stock, valued for such purpose at a price of $10 per share, to the holders of all of the shares of our 8% Series A Cumulative Convertible Redeemable Preferred Stock, par value $.0001 per share, in exchange for all of the outstanding shares of our Series A Preferred Stock at its initial stated value of $20.0 million plus all accrued and unpaid dividends; and

an amendment to our Amended and Restated Certificate of Incorporation to increase our number of authorized shares of common stock from 20,000,000 to 45,000,000 shares.

As previously disclosed in our Current Report on Form 8-K filed with the SEC on October 8, 2004, on October 4, 2004 we entered into a Common Stock Purchase Agreement with The Price Group, the Sol and Helen Price Trust, the Price Family Charitable Fund, the Robert and Allison Price Charitable Remainder Trust and the Robert and Allison Price Trust 1/10/75 to effectuate the private placement and the exchange of shares of our common stock for all of our outstanding Series B Preferred Stock and the current obligations, as described above. On October 25, 2004, the Price Family Charitable Fund donated its shares of Series B Preferred Stock to a public charity on the condition that such charity agree to be subject to the terms and conditions of the Common Stock Purchase Agreement. On October 29, 2004, following approval by our common stockholders of the above described transaction at a special meeting of stockholders called for such purpose, we issued an aggregate of 7,161,926 shares of common stock to The Price Group, the Sol and Helen Price Trust and the Robert and Allison Price Trust 1/10/75 to consummate the private placement and the exchange of common stock for all of our outstanding Series B Preferred Stock and the current obligations on the condition that such entities agree not to exercise or convey any rights they may receive pursuant to this rights offering on such shares. In connection therewith, we also issued 300,000 shares of common stock to the Robert and Allison Price Charitable Remainder Trust. We have agreed to register with the SEC for resale all 7,461,926 of these shares together with 500,000 shares of common stock issued to the public charity pursuant to the exchange of our common stock for all of our Series B Preferred Stock. On November 23, 2004, we issued 61,135 shares of our common stock to the Sol and Helen Price Trust pursuant to the offer to the holders of our Series A Preferred Stock to exchange shares of our common stock for all of our outstanding shares of Series A Preferred Stock. The Sol and Helen Price Trust has agreed not to exercise or convey any rights it may receive on the 61,135 shares of common stock it received pursuant to such exchange.

As mentioned above, if upon expiration of the $7 subscription period we have not received at least $25.0 million in proceeds from the rights offering, The Price Group has agreed to purchase from us the number of shares of our common stock equal to the shortfall, if any, divided by $8, at a price of $8 per share. Concurrent with this purchase of common stock by The Price Group, we will grant The Price Group a non-transferable put option giving The Price Group the right, at its election, to require us to purchase at any time during the thirty (30) days following the end of the rights offering subscription period a number of shares equal to the lesser of (i) the dollar amount raised by us from the exercise of rights upon the conclusion of the $8 subscription period divided by $8, and (ii) the number of shares purchased by The Price Group upon the conclusion of the $7 subscription period, in each case at a price of $8 per share. We have agreed to register with the SEC for resale the shares of our common stock issuable in connection with the purchase by The Price Group upon the conclusion of the $7 subscription period, if any. If the rights offering is 0% subscribed upon expiration of the $7 subscription period, this purchase by The Price Group will require the issuance of 3,125,000 shares of common stock.

As previously stated, the Prices comprise a group that may be deemed to beneficially own greater than 50% of our common stock. The following table reflects the dilution of the Prices ownership in our common stock

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through the rights offering assuming different levels of stockholder participation in the rights offering. The table assumes each stockholder will subscribe in the rights offering proportionately to the overall level of subscription, meaning that if the rights offering is 50% subscribed, each individual stockholder will exercise 50% of his, her or its rights. This table also assumes that the Prices do not exercise any rights granted to them pursuant to the rights offering. However, the Prices may exercise rights granted to them pursuant to the rights offering on an aggregate of 3,566,512 shares of common stock.

	Stockholder Subscription of the Rights Offering		
	50% Subscribed	25% Subscribed	0% Subscribed
The Prices Beneficial Ownership of Common Stock	40%	47%	61%

As described above, the Prices are the beneficial owners of greater than 50% of our common stock, and depending on the extent to which the rights offering is subscribed by our common stockholders, may continue to be the beneficial owners of greater than 50% of our common stock following the rights offering.

Determination of Subscription Price

After discussions with management about our financial condition and long-term operating goals and after a consideration of what would be fair to us and our unaffiliated stockholders, representatives of The Price Group proposed the value to be ascribed to our common stock for purposes of the $25.0 million private placement, the exchange of common stock for all of our outstanding Series B Preferred Stock and the exchange of our common stock for the up to $20.0 million in current obligations owed to The Price Group. Concurrently therewith, such representatives also proposed the prices per share for this rights offering, the potential purchase by The Price Group of up to 3,125,000 shares of our common stock at $8 per share upon the conclusion of the $7 subscription period and the exercise price of the put option that would be granted in connection with such purchase by The Price Group, if any. Except for the $7 per share price applicable during the first month of the rights offering, the deemed values for the common stock were greater than the market price of the common stock at the time the initial proposals were made to us. The deemed exchange value for the common stock used in the offer to exchange our common stock for all of our outstanding Series A Preferred Stock was separately negotiated by our outside counsel and counsel to plaintiffs in the federal class action lawsuit entitled *Performance Capital, L.P. v. PriceSmart, Inc. et al*. These exchange values were estimates only, and there can be no assurance that our common stock will attain, or maintain for any period of time, a market price approaching such estimate in the future.

Expiration Time

You may exercise your subscription privilege at any time before the expiration time, which is 5:00 p.m., New York City time, on Friday, January 21, 2005, in order to exercise a right at a subscription price of $7, or from the expiration of the $7 subscription period until 5:00 p.m., New York City time on Wednesday, December 21, 2005 to exercise a right at a subscription price of $8, unless the rights offering is terminated or extended. If you do not exercise your rights before the expiration of the $8 subscription period, your rights will expire and become null and void. If you desire to exercise your rights during the $7 subscription period, we will not be obligated to honor your exercise of rights if the subscription agent receives any of the required documents relating to your exercise of such subscription privilege after the expiration time for the $7 subscription period, regardless of when you transmitted the documents, unless you have timely transmitted the documents pursuant to the guaranteed delivery procedures described below. If the subscription agent receives documents related to an exercise of rights at a subscription price of $7 after the expiration of the $7 subscription period, your subscription price will be returned to you. We will not be obligated to honor your exercise of rights if the subscription agent receives any of the required documents relating to your exercise of subscription privileges after the expiration of the $8 subscription period, regardless of when you transmitted the documents, unless you have timely transmitted the documents pursuant to the guaranteed delivery procedures described below.

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We may extend the expiration time for the $7 subscription period or the $8 subscription period for any reason, and you will not be able to revoke your exercise of subscriptions.

If we elect to extend the expiration time for the $7 subscription period or the $8 subscription period, we will issue a press release announcing the extension before 9:00 a.m. Pacific time on the first business day after the most recently announced expiration time.

Subscription Privilege

Each right entitles the holder to purchase 1.5 shares of our common stock, upon delivery of the required documents and payment of the proper subscription price per share, prior to the expiration time. You are not required to exercise your subscription privilege.

Exercising Your Rights

You may exercise your rights by delivering the following to the subscription agent before the expiration time for the $7 subscription period or the $8 subscription period:

- your properly completed and executed rights certificate evidencing the exercised rights with any required signature medallion guarantees or other supplemental documentation; and

- your payment in full of the subscription price for each share of common stock subscribed for pursuant to the subscription privilege.

Alternatively, if you deliver a notice of guaranteed delivery together with your subscription price payment prior to the expiration time for the $7 subscription period or the $8 subscription period, as the case may be, you must deliver the rights certificate within three business days following the expiration time for the $7 subscription period or the $8 subscription period, as the case may be, using the guaranteed delivery procedures described below under the heading Guaranteed Delivery Procedures.

Payment of Subscription Price

Your cash payment of the subscription price for the rights must be made by either certified check, bank draft or money order payable to Mellon Bank, N.A. Your cash payment of the subscription price for the rights will be deemed to have been received by the subscription agent only when the subscription agent receives your certified check, bank draft or money order.

We will retain any interest earned on any cash funds held by the subscription agent in connection with the rights offering prior to the consummation of the rights offering or the return of such funds, if required, pursuant to this prospectus.

The subscription agent will hold your payment of the subscription price for the rights in a segregated account with other payments received from holders of rights until we issue to you your shares of common stock or return your overpayment, if any.

Exercising a Portion of Your Rights

If you subscribe for fewer than all of the shares of common stock that you are eligible to purchase pursuant to the subscription privilege represented by your rights certificate, you may, under certain circumstances, request from the subscription agent, a new rights certificate representing the unused rights and then attempt to sell your unused rights. See Method of Transferring and Selling Rights below.

Alternatively, you may transfer a portion of your rights and request from the subscription agent, a new rights certificate representing the rights you did not transfer.

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Calculation of Rights Exercised

If you do not indicate the number of shares being purchased for the rights you receive, or do not forward full payment of the aggregate subscription price for the number of shares that you indicate are being purchased, then you will be deemed to have exercised the subscription privilege with respect to the maximum number of shares that may be purchased for the aggregate subscription price payment received by the subscription agent. If your full subscription price payment is not applied to your purchase of shares of common stock, the subscription agent will return to you by mail or similarly prompt means, or as otherwise instructed by us, the excess amount without interest or deduction as soon as practicable.

Instructions for Completing the Rights Certificates

You should read and follow the instructions accompanying the rights certificates carefully. If you want to exercise your rights, you must send your completed rights certificates, any necessary accompanying documents and payment of the subscription price to the subscription agent. **You should not send the rights certificates, any related documentation or payment of the subscription price to us**. Any rights certificates and other items received by us relating to the subscriptions will be returned to the sender.

You bear all risk for the method of delivery of rights certificates, any necessary accompanying documents and payment of the subscription price to the subscription agent. If you send the rights certificates and other items by mail, we recommend that you send them by registered mail, properly insured, with return receipt requested. You should allow a sufficient number of days to ensure delivery and clearance of cash payment prior to the expiration time.

Signature Medallion Guarantee May Be Required

Your signature on each rights certificate must be medallion guaranteed by an eligible institution such as a member firm of a registered national securities exchange, a member of the National Association of Securities Dealers, Inc. or a commercial bank or trust company having an office or correspondent in the United States, subject to standards and procedures adopted by the subscription agent, unless:

- your rights certificate is registered in your name; or
- you are an eligible institution.

Delivery of Subscription Materials and Payment

You should deliver your rights certificate and payment for the common stock subscribed for, as well as any nominee holder certifications, notices of guaranteed delivery and any other required documentation to the subscription agent, Mellon Bank, N.A. as follows:

By Mail:

PriceSmart, Inc.

c/o Mellon Bank, N.A.

Attention: Reorganization Dept.

P.O. Box 3301

South Hackensack, NJ 07606

By Hand:

PriceSmart, Inc.

c/o Mellon Bank, N.A.

Attention: Reorganization Dept.

120 Broadway, 13th Floor

New York, NY 10271

By Overnight Courier:

PriceSmart, Inc.

c/o Mellon Bank, N.A.

Attention: Reorganization Dept.

85 Challenger Road, 2nd Floor

Overpeck Centre

Ridgefield Park, NJ 07660

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Guaranteed Delivery Procedures

If you wish to exercise your rights, but you do not have sufficient time to deliver the rights certificate evidencing your rights to the subscription agent before the expiration of the $7 or $8 subscription period, as the case may be, you may exercise your rights by the following guaranteed delivery procedures:

- provide your payment in full of the subscription price for each share of common stock being subscribed for pursuant to the subscription privilege to the subscription agent before the applicable expiration time;
- deliver a notice of guaranteed delivery to the subscription agent at or before the expiration time; and
- deliver the properly completed rights certificate evidencing the rights being exercised (and, if applicable for a nominee holder, the related nominee holder certification), with any required signatures medallion guaranteed, to the subscription agent, within three business days following the expiration time for the $7 subscription period or the $8 subscription period, as the case may be.

Your notice of guaranteed delivery must be substantially in the form provided with the Instructions for Use of PriceSmart, Inc. Common Stock Rights Certificates distributed to you with your rights certificate. Your notice of guaranteed delivery must come from an eligible institution which is a member of, or a participant in, a signature guarantee medallion program acceptable to the subscription agent. In your notice of guaranteed delivery you must state:

- your name;
- the number of rights represented by your rights certificate, the number of shares of common stock you are subscribing for pursuant to the subscription privilege; and
- your guarantee that you will deliver to the subscription agent any rights certificates evidencing the rights you are exercising within three business days following the expiration time for the $7 subscription period or the $8 subscription period, as the case may be.

You may deliver the notice of guaranteed delivery to the subscription agent in the same manner as the rights certificate at the addresses set forth under Delivery of Subscription Materials and Payment above.

Eligible institutions may also transmit the notice of guaranteed delivery to the subscription agent by facsimile transmission to (201) 296-4293. To confirm facsimile deliveries, you may call (201) 296-4860.

The information agent will send you additional copies of the form of notice of guaranteed delivery if you need them. Please call the information agent at (888) 867-6003.

Notice to Nominees

If you are a broker, a dealer, a trustee or a depositary for securities who holds shares of our common stock for the account of others as a nominee holder, you should notify the respective beneficial owners of those shares of the issuance of the rights as soon as possible to find out the beneficial owners intentions. You should obtain instructions from the beneficial owner with respect to the rights, as set forth in the instructions we have provided to you for your distribution to beneficial owners. If the beneficial owner so instructs, you should complete the appropriate rights certificates and submit them to the subscription agent with the proper payment. A nominee holder that holds shares of common stock for the account(s) of more than one beneficial owner may exercise the number of rights to which all such beneficial owners in the aggregate otherwise would have been entitled if they had been direct record holders of common stock on the record date, so long as the nominee submits the appropriate rights certificates and certifications and proper payment to the subscription agent.

If you hold shares of common stock as a nominee holder for beneficial owners whose address is outside the United States, see Foreign Stockholders.

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Beneficial Owners

If you are a beneficial owner of shares of our common stock or rights that you hold through a nominee holder, we will ask your broker, dealer or other nominee to notify you of this rights offering. If you wish to exercise your rights, you will need to have your broker, dealer or other nominee act for you. To indicate your decision with respect to your rights, you should complete and return to your broker, dealer or other nominee the form entitled Beneficial Owners Election Form. You should receive this form from your broker, dealer or other nominee with the other subscription materials. If you are outside the United States, see Foreign Stockholders.

Procedures for DTC Participants

We expect that the rights will be eligible for transfer, and that your exercise of your subscription privilege with respect to rights may be made, through the facilities of DTC.

Determinations Regarding the Exercise of Rights

We will decide all questions concerning the timeliness, validity, form and eligibility of your exercise of rights. Our decisions will be final and binding. We, in our sole discretion, may waive any defect or irregularity, or permit a defect or irregularity to be corrected within whatever time we determine. We may reject the exercise of any of your rights because of any defect or irregularity. Your subscription will not be deemed to have been received or accepted until all irregularities have been waived by us or cured by you within the time we decide, in our sole discretion.

We reserve the right to reject your exercise of rights if your exercise is not in accordance with the terms of the rights offering or in proper form. Neither we nor the subscription agent will have any duty to notify you of a defect or irregularity in your exercise of the rights. We will not be liable for failing to give you that notice. We will also not accept your exercise of rights if our issuance of shares of common stock pursuant to your exercise could be deemed unlawful or materially burdensome. See Regulatory Limitation and Compliance with Regulations Pertaining to the Rights Offering below.

No Revocation of Exercised Rights

Once you have exercised your subscription privilege and you may not revoke your exercise. Even if we extend the expiration time for the $7 subscription period or the $8 subscription period, you may not revoke your exercise.

Subscription Agent

We have appointed Mellon Bank, N.A. as subscription agent for the rights offering. We will pay its fees and expenses related to the rights offering and have agreed to indemnify it from liabilities it may incur in connection with the rights offering.

Information Agent

We have appointed Mellon Bank, N.A. as information agent for the rights offering. We will pay its fees and expenses related to the rights offering and have agreed to indemnify it from liabilities it may incur in connection with the rights offering. You may direct any questions or requests for assistance concerning the method of exercising your rights, additional copies of this prospectus, the instructions for the rights, the nominee holder certification, the notice of guaranteed delivery or other

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subscription materials referred to herein, to the information agent for the rights offering, at the following telephone number and address:

Mellon Bank, N.A.

85 Challenger Road, 2nd Floor

Overpeck Centre

Ridgefield Park, NJ 07660

TOLL FREE: (888) 867-6003

Method of Transferring and Selling Rights

The rights will be listed for trading on the Nasdaq National Market under the symbol PSMTR . We expect that the rights may be purchased or sold through usual investment channels until 5:00 p.m., New York City time, on Wednesday, December 21, 2005, the expiration time for the $8 subscription period. You may not sell, transfer or send your rights or rights certificate to anyone outside the United States unless the foreign person provides evidence satisfactory to us that such sale or transfer is lawful. There has been no prior public market for the rights, and we cannot assure you that a trading market for the rights, will exist or develop or, if a market develops, that the market will remain available throughout the subscription period. We also cannot assure you of the price at which the rights will trade, if at all. If you do not exercise or sell your rights you will lose any value inherent in the rights. See General Considerations Regarding the Partial Exercise, Transfer or Sale of Rights below.

Transfer of Rights

You may transfer rights in whole by endorsing the rights certificate for transfer and by following the instructions for transfer included in the information sent to you with your rights certificate. If you wish to transfer only a part of the rights, you should deliver your properly endorsed rights certificate to the subscription agent. With your rights certificate, you should include instructions to register in the name of the transferee such portion of the rights evidenced thereby that you wish to transfer and to issue a new rights certificate to the transferee evidencing that portion of the rights that you wish to transfer. You may only transfer whole rights and not fractions of a right. If there is sufficient time before the expiration of the $8 subscription period, the subscription agent will send you a new rights certificate evidencing the balance of the rights issued to you but not transferred to the transferee. You may also instruct the subscription agent to send the rights certificate to one or more additional transferees. If you wish to sell your remaining rights, you may request that the subscription agent transfer your certificates representing your remaining rights to your broker or dealer so that you may sell them through your broker or dealer. You may also request that the subscription agent, sell your rights for you, as described below.

We and the subscription agent reserve the right without liability to treat as invalid any exercise or purported exercise of rights evidenced by a completed rights certificate or any transfer or purported transfer of a rights certificate that appears to us or the subscription agent to have been executed, effected or dispatched into, in or from a jurisdiction other than the United States or if the transferee of any purported transfer of a rights certificate appears to be resident outside the United States unless it is otherwise lawful for them to do so. At the time of transfer or exercise, these foreign persons must provide evidence satisfactory to us, such as a legal opinion from local counsel, that it is lawful for them to do so.

If you wish to transfer all or a portion of your rights, you should allow a sufficient amount of time prior to the expiration of the $8 subscription period for the subscription agent to:

- receive and process your transfer instructions; and
- issue and transmit a new rights certificate to your transferee or transferees with respect to transferred rights, and to you with respect to any rights you retained.

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Neither we nor the subscription agent will have any liability to you if you or your transferee does not receive any new rights in time to exercise or transfer such rights.

If you wish to transfer your rights, your rights certificate must be medallion guaranteed by an eligible institution.

Sales of Rights through the Subscription Agent

If you choose not to sell your rights through your broker or dealer, you may seek to sell your rights only through the subscription agent. If you wish to have the subscription agent seek to sell your rights, you must deliver your properly executed rights certificate, with appropriate instructions, to the subscription agent. If you want the subscription agent to seek to sell only part of your rights, you must send the subscription agent instructions setting forth what you would like done with the rights, along with your rights certificate. You may only seek to sell whole rights and not fractions of a right through the subscription agent.

If the subscription agent sells rights for you, the subscription agent will send you by mail a check for the net proceeds from the sale of any of your rights as soon as practicable after such sale. If your rights can be sold, the sale will be placed, to the extent possible, with a broker on the next trading day on the Nasdaq National Market following receipt of the sale request. You will be deemed to have sold your rights at the actual sale price received for such sale. The fees charged by the subscription agent for selling rights will be deducted from the sale price for such rights sold. We cannot assure you, however, that a market will develop for the rights or that the subscription agent will be able to sell your rights.

You must have your order to sell your rights to the subscription agent before 11:00 a.m., New York City time, on Wednesday, December 14, 2005, the fifth business day before the expiration of the $8 subscription period. If less than all sales orders received by the subscription agent are filled, the sales proceeds will be prorated among you and the other rights holders based upon the number of rights that each holder has instructed be sold during that period, irrespective of when during the period the instructions are received. The subscription agent is required to sell your rights only if the subscription agent is able to find buyers. If the subscription agent cannot sell your rights by 5:00 p.m., New York City time, on Friday, December 16, 2005, the third business day before the expiration of the $8 subscription period, the subscription agent will return your rights certificate to you by overnight delivery.

IF YOU SELL YOUR RIGHTS THROUGH YOUR BROKER OR DEALER, YOU MAY RECEIVE A DIFFERENT AMOUNT OF PROCEEDS THAN IF YOU SELL THE SAME AMOUNT OF RIGHTS THROUGH THE SUBSCRIPTION AGENT. IF YOU SELL YOUR RIGHTS THROUGH YOUR BROKER OR DEALER INSTEAD OF THE SUBSCRIPTION AGENT, YOUR SALES PROCEEDS WILL BE THE ACTUAL SALES PRICE OF YOUR RIGHTS LESS ANY FEES, COMMISSIONS AND EXPENSES.

General Considerations Regarding the Partial Exercise, Transfer or Sale of Rights

The amount of time needed by your transferee to exercise or sell its rights depends upon the method by which the transferor delivers the rights certificates, the method of payment made by the transferee and the number of transactions which the holder instructs the subscription agent to effect. You should allow a sufficient amount of time for your transferee to exercise or sell the rights transferred to it. Neither we nor the subscription agent will be liable to a transferee or transferor of rights if rights certificates or any other required documents are not received in time for exercise or sale prior to the expiration of the $7 subscription or the $8 subscription period.

You will receive a new rights certificate upon a partial exercise, transfer or sale of rights only if the subscription agent receives your properly endorsed rights certificate no later than 5:00 p.m., New York City time, on Wednesday, December 14, 2005, five business days before the expiration of the $8 subscription period. Neither the subscription agent nor we will issue a new rights certificate if your rights certificate is

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received after that time and date. If your instructions and rights certificate are received by the subscription agent after that time and date, you will not receive a new rights certificate and therefore will not be able to sell or exercise your remaining rights.

You are responsible for all commissions, fees and other expenses (including brokerage commissions and transfer taxes) incurred in connection with the purchase, sale or exercise of your rights, except that we will pay any fees of the subscription agent associated with the exercise of rights. Any amounts you owe will be deducted from your account.

A request to exercise rights will constitute a warranty by you that you and the beneficial owner of the rights are within the United States, except if you have otherwise provided evidence to our satisfaction, such as a legal opinion from local counsel, that it is lawful for you to receive rights and exercise rights and acquire shares. A transfer of rights will constitute a warranty that the transferor is within the United States or is otherwise entitled to transfer the rights and a warranty from the transferee that the transferee and any beneficial owner of the rights for whom the transferee acts are within the United States or that it is otherwise lawful for them to receive rights and exercise rights and acquire shares of common stock.

If you do not exercise your rights before the expiration of the $8 subscription period, your rights will expire and will no longer be exercisable.

Effect on Stock Options

All of our outstanding stock options were issued pursuant to plans previously adopted by our board of directors. Holders of options to purchase shares of our common stock will not receive rights. We plan to make an equitable adjustment to all of our outstanding stock options to preserve the benefits or potential benefits intended to be made available pursuant to the options. Such future adjustment shall be made by the Compensation Committee of our Board of Directors.

No Recommendations to Rights Holders

Neither we nor our board of directors has made any recommendation as to whether you should exercise your rights or transfer your rights. You should decide whether to transfer your rights, subscribe for shares of our common stock or simply take no action with respect to your rights, based upon your own assessment of your best interests.

Termination

There are no conditions to the consummation of the rights offering. However, we may terminate the rights offering for any reason at any time before the expiration of the $7 subscription period or the $8 subscription period. If we terminate the rights offering, we will promptly issue a press release announcing the termination, and we will promptly thereafter return all subscription payments, provided that shares of common stock have not been issued pursuant to such subscription payment. We will not be obligated to issue shares to rights holders that have exercised their rights prior to the termination of the rights offering. We will not pay interest on, or deduct any amounts from, subscription payments if we terminate the rights offering.

Foreign Stockholders

We will not mail rights certificates to stockholders on the record date or to subsequent transferees whose addresses are outside the United States because their exercise of rights may be prohibited by the laws of the country in which they live. Instead, we will have the subscription agent hold the rights certificates for those holders accounts. Foreign holders may exercise their subscription privilege at any time before 11:00 a.m., New York City time, on Friday, January 14, 2005, in order to exercise a right at a subscription price of $7, or from the expiration of the $7 subscription period until 11:00 a.m., New York City Time on Wednesday, December 14, 2005 to exercise a right at a subscription price of $8, unless the rights offering is terminated or extended. To transfer their rights, foreign holders must notify the subscription agent before 11:00 a.m., New York City time, on Wednesday, December 14, 2005, five business days prior to the expiration of the $8 subscription period and must establish to our satisfaction that such exercise or transfer is permitted under applicable law. If a foreign holder does not establish to our satisfaction that such exercise or transfer is permitted under applicable law, and notify, and provide acceptable instructions to, the subscription agent by such time (and if no contrary instructions have been received by such time), the subscription agent will seek to sell the foreign holder s rights, subject to the subscription agent s ability to find a purchaser. Any such sales will be deemed to have been made at the actual sale price received in such sale by the subscription agent. If the subscription agent sells a foreign holder s rights, the subscription agent will send the foreign holder by mail a check for the net proceeds from the sale of any rights of the foreign holder. See Method of Transferring and Selling Rights, Transfer of Rights and Sales of Rights Through the Subscription Agent above. The proceeds, if any, resulting from sales of rights of holders whose addresses are not known by the subscription agent or to whom delivery cannot be made will be held in an interest bearing account. Any amount remaining unclaimed on the second anniversary of the expiration time will be turned over to us. If you live outside of the United States, you should consult with your legal advisor about the particular laws of the country in which you live.

If you hold shares of our common stock through a broker, a dealer, a trustee or a depository within the United States as a nominee holder and you are outside the United States, neither you nor your nominee may attempt to exercise any rights unless you have provided evidence satisfactory to us, such as a legal opinion from local counsel, that it is not unlawful for you to receive and exercise rights without any requirement being imposed on us to be registered or licensed.

Regulatory Limitation

We will not be required to issue to you shares of our common stock pursuant to the rights offering if, in our opinion, you would be required to obtain prior clearance or approval from any state or federal regulatory authorities to own or control such shares and if, at the time of the expiration of the $8 subscription period, you have not obtained such clearance or approval.

Issuance of Common Stock

Unless we earlier terminate the rights offering, the subscription agent will issue the shares of our common stock purchased in the rights offering as soon as practicable following receipt of a properly completed and signed rights certificate together with payment of the subscription price for each share of common stock subscribed for. Each subscribing holder s new shares will be issued in the same form, certificated or book-entry, as the rights exercised by that holder.

Your payment of the aggregate subscription price for our common stock will be retained by the subscription agent and will not be delivered to us, unless and until your subscription is accepted and you are issued your shares of common stock. We will not pay you any interest on funds paid to the subscription agent, regardless of whether the funds are applied to the subscription price or returned to you. You will have no rights as a stockholder of our company with respect to the subscribed for shares of our common stock until the certificates representing such shares are issued to you or the shares are deposited in the book-entry account held on your behalf. Upon our issuance of the certificates or the deposit of the shares in the applicable book-entry account, you will be deemed the owner of the shares you purchased by exercise of your rights. Unless otherwise instructed in the rights certificates, the shares issued to you pursuant to your subscription will be registered in your name or the name of your nominee, if applicable. We will not issue any fractional shares of common stock.

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Shares of Common Stock Outstanding

As of November 24, 2004, we had outstanding 17,524,840 shares of our common stock, not including treasury shares. The number of outstanding shares of our common stock will increase by 16,052,668 shares, following the issuance of all shares purchased in the rights offering (assuming that the rights offering is fully subscribed and given that the Prices have agreed not to exercise any rights they may receive on 7,223,061 shares of our common stock beneficially owned by them as of the record date). This represents an approximate 92% increase in the number of outstanding shares of our common stock as of November 24, 2004.

Compliance with Regulations pertaining to the Rights Offering

We are not making the rights offering in any state or other jurisdiction in which it is unlawful to do so. We will not sell or accept an offer to purchase shares of our common stock from you if you are a resident of any state or other jurisdiction in which the sale or offer of the rights would be unlawful. We may delay the commencement of the rights offering in certain states or other jurisdictions in order to comply with the laws of those states or other jurisdictions. However, we may decide, in our sole discretion, not to modify the terms of the rights offering as may be requested by certain states or other jurisdictions. If that happens and you are a resident of the state or jurisdiction that requests the modification, you will not be eligible to participate in the rights offering. We do not expect that there will be any changes in the terms of the rights offering.

MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

Scope of Discussion

The following discussion is a summary of the U.S. federal income tax consequences that are expected to be material to a typical U.S. holder (defined below) that receives rights distributed pursuant to the rights offering and that either (i) exercises such rights, (ii) allows such rights to expire, or (iii) sells, exchanges, or otherwise disposes of such rights. With the exception of the tax consequences described below under the heading Termination of Rights Offering, the following discussion assumes that we will not terminate the rights offering.

This discussion is based on current provisions of the Internal Revenue Code, which we refer to as the Code, applicable current, temporary and proposed Treasury regulations promulgated thereunder, which we refer to as the Treasury Regulations, the legislative history of the Code and publicly available administrative and judicial interpretations thereof, all as in effect as of the date of this prospectus and all of which are subject to change, possibly with retroactive effect, or to different interpretations. In addition, the administrative interpretations and practices of the Internal Revenue Service include its practices and policies as expressed in private letter rulings which are not binding on the Internal Revenue Service, except with respect to the particular taxpayers who requested and received these rulings. This discussion is included for general information purposes only and does not purport to be a complete technical analysis or listing of all potential tax considerations that may be relevant to U.S. holders in light of their particular circumstances. This discussion does not address any state, local or foreign tax consequences or any non-income tax consequences (such as estate or gift tax consequences). This discussion applies only to U.S. holders that hold shares of our common stock as capital assets and that will hold the rights distributed pursuant to the rights offering as capital assets (and, in the event such rights are exercised, will hold newly acquired shares of our common stock as capital assets), in each case, within the meaning of Section 1221 of the Code. This discussion also does not address the United States federal income tax consequences to a U.S. holder that is one of our affiliates or that is subject to special rules under the Code, including but not limited to:

a financial institution, insurance company, or regulated investment company;

persons who are subject to alternative minimum tax;

a tax-exempt organization, retirement plan, or mutual fund;

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- a dealer, broker, or trader in securities;
- non-U.S. holders (as defined below);
- an entity treated as a partnership for U.S. federal income tax purposes;
- a stockholder that owns its shares of our common stock indirectly through an entity treated as a partnership for United States federal income tax purposes, or a trust or estate;
- persons deemed to sell their shares of common stock under the constructive sale provisions of the Code;
- a stockholder that holds its shares of our common stock as part of a hedge, appreciated financial position, straddle or conversion transaction; or
- a stockholder that acquired our common stock pursuant to the exercise of compensatory stock options or otherwise as compensation.

We will not seek a ruling from the Internal Revenue Service, or the IRS, with respect to the rights offering. The IRS could take positions concerning the tax consequences of the rights offering that are different from those described in this discussion, and, if litigated, a court could sustain any such positions taken by the IRS.

For purposes of this discussion, the term U.S. holder means a holder of shares of our common stock that, for U.S. federal income tax purposes, is:

- a citizen or resident of the U.S.;
- a corporation or other entity treated as a corporation for U.S. federal income tax purposes created or organized in the U.S. or under U.S. laws or the laws of any state or political subdivision thereof;
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust (i) if, in general, a court within the U.S. is able to exercise primary jurisdiction over its administration and one or more U.S. persons have authority to control all of its substantial decisions or (ii) that has a valid election in effect under applicable Treasury Regulations to be treated as a U.S. person.

A non-U.S. holder is a holder other than a U.S. holder. If a holder of our common stock is a non-U.S. holder, the tax consequences of the rights offering to such holder will depend upon a variety of factors, including whether such person conducts a trade or business in the U.S. Non-U.S. holders are urged to consult their own tax advisors regarding the tax consequences associated with the rights offering.

Holders of our common stock are urged to consult their own tax advisors regarding the specific tax consequences associated with the rights offering, including the applicability and effect of any state, local, foreign, or other tax laws as well as changes in applicable tax laws.

Distribution of Rights

Pursuant to Section 305 of the Code and the Treasury Regulations issued thereunder, a U.S. holder that receives rights pursuant to the rights offering will not be required to recognize taxable income for U.S. federal income tax purposes upon the receipt of such rights unless, among other things, the distribution of rights results in both the receipt of property by some stockholders and an increase in the proportionate interests of other stockholders in our assets or earnings and profits. In this discussion, we refer to a distribution that has both of these consequences as a disqualified distribution. For the purpose of determining whether a disqualified distribution has occurred, the term stockholder includes a holder of rights to acquire our stock.

As described under the heading The Rights Offering Effect on Stock Options, we plan to adjust the terms of our outstanding stock options. The Treasury Regulations under Section 305 of the Code provide that the failure to properly adjust stock options following the distribution of stock rights may cause the stock rights to be a disqualified distribution. However, the Treasury Regulations do not adequately address whether the terms of compensatory stock options must be adjusted and, if an adjustment is required, how the adjustment should be made. We believe that the adjustments we plan to make to our stock options should satisfy the requirements in the Treasury Regulations if those regulations apply to our compensatory stock options. However, there is a risk that the IRS might not agree with our approach.

Based on our belief that the adjustment of our stock options does not cause the rights offering to be a disqualified distribution, we believe, and the remainder of this discussion assumes, that a U.S. holder that receives rights pursuant to the rights offering should not be required to recognize taxable income for U.S. federal income tax purposes and we intend to report the rights offering accordingly. However, if our intended treatment of the rights offering were challenged by the IRS and if such challenge were ultimately upheld, the U.S. federal income tax consequences to a U.S. holder that receives rights pursuant to the rights offering may differ from the consequences described herein, and it is possible that a U.S. holder s receipt of rights pursuant to the rights offering may be taxable as a dividend.

Basis and Holding Period of Rights

If, in accordance with Section 307 of the Code, the fair market value of the rights which we distribute to a U.S. holder is less than 15% of the fair market value of such U.S. holder s shares of our common stock with respect to which such rights were distributed, such U.S. holder s basis in the rights distributed generally will be zero. A U.S. holder may elect, however, to allocate its basis in our common stock between such common stock and the rights received in proportion to the fair market value of such common stock and such rights. This election may be made pursuant to Section 307 of the Code and the Treasury Regulations thereunder and will be irrevocable once made.

If the fair market value of the rights which we distribute to a U.S. holder is 15% or more of the fair market value of such U.S. holder s shares of our common stock with respect to which such rights were distributed, such U.S. holder will be required to allocate its basis between such common stock and such rights in proportion to their relative fair market values.

In either case, a U.S. holder s holding period for the rights that we distribute to such U.S. holder will include the holding period of such U.S. holder s shares of our common stock with respect to which such rights were distributed.

Exercise of Rights; Basis and Holding Period of Acquired Shares; Sale, Exchange or Other Disposition of Acquired Shares

A U.S. holder will not recognize gain or loss upon the exercise of the rights. A U.S. holder s basis in our common stock acquired through exercise of the rights generally will equal the sum of (i) the subscription price paid by such U.S. holder to acquire such common stock and (ii) such U.S. holder s basis, if any, in the rights exercised. A U.S. holder s holding period in shares of our common stock acquired through the exercise of rights will begin on the day such U.S. holder exercises the rights.

Upon the sale, exchange or other disposition of our common stock acquired upon the exercise of rights, a U.S. holder generally will recognize gain or loss equal to the difference between the amount realized and such U.S. holder s basis in such common stock. Such gain or loss will be capital gain or loss and will be long-term

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capital gain or loss if a U.S. holder s holding period exceeds one year at the time of the sale, exchange or other disposition. Long-term capital gains of certain non-corporate taxpayers generally are taxed at lower rates than items of ordinary income. The deductibility of capital losses is subject to limitations.

Expiration of Rights

If a U.S. holder receives rights pursuant to the rights offering, such U.S. holder s basis in our common stock is not allocated between such common stock and the rights received and such U.S. holder s rights expire unexercised, then such U.S. holder will not recognize a taxable loss upon expiration of the rights. In addition, such U.S. holder s basis in its shares of our common stock will not be affected by this rights offering and such U.S. holder s decision to allow its rights to expire and will remain the same as before the rights offering.

If a U.S. holder receives rights pursuant to the rights offering, such U.S. holder s basis in our common stock is allocated between such common stock and the rights received and such U.S. holder s rights expire unexercised, then such U.S. holder will recognize a taxable loss upon the expiration of the rights equal to the basis that was allocated to the rights. Such loss will be a capital loss.

Sale, Exchange or Other Disposition of Rights

Upon the sale, exchange or other disposition of rights, a U.S. holder generally will recognize capital gain or loss equal to the difference between the amount realized and such U.S. holder s basis in the rights. Such gain or loss will be long-term capital gain or loss if a U.S. holder s holding period in the rights is more than one year on the date of the sale, exchange or other disposition. Long-term capital gains generally are taxed at lower rates than items of ordinary income. The deductibility of capital losses is subject to limitations.

Termination of Rights Offering

If a U.S. holder receives rights pursuant to the rights offering, such U.S. holder s basis in our common stock is not allocated between such common stock and the rights received and such U.S. holder retains such rights, then, if we subsequently terminate the rights offering: (i) such U.S. holder will not recognize income, gain or loss as a result of the distribution, ownership or termination of the rights; and (ii) such U.S. holder s basis in its shares of our common stock with respect to which the rights were distributed will not be affected by the rights offering.

If a U.S. holder receives rights pursuant to the rights offering, such U.S. holder s basis in our common stock is allocated between such common stock and the rights received and such U.S. holder retains such rights, then, if we subsequently terminate the rights offering, such U.S. holder will recognize a taxable loss as a result of the termination of the rights equal to the basis that was allocated to the rights. Such loss will be a capital loss.

If a U.S. holder receives rights pursuant to the rights offering and such U.S. holder sells, exchanges or otherwise disposes of such rights, then, while the matter is not entirely free from doubt, if we subsequently terminate the rights offering, such U.S. holder should recognize gain or loss equal to the difference between the amount realized upon the sale of the rights and such U.S. holder s basis, if any, in the rights. Such gain or loss will be long-term gain or loss if such U.S. holder s holding period for the rights exceeds one year at the time of sale, exchange or other disposition.

Backup Withholding

A U.S. holder that sells, exchanges or otherwise disposes of shares of our common stock acquired upon the exercise of rights or that sells, exchanges or otherwise disposes of rights may be subject to backup withholding on the proceeds received, unless such U.S. holder:

- is a corporation or other exempt recipient and, when required, establishes this exemption; or

- provides a correct taxpayer identification number, certifies that it is not currently subject to backup withholding, and otherwise complies with the applicable requirements of the backup withholding rules.

Backup withholding is not an additional tax. Any amount withheld under the backup withholding rules will generally be creditable against the United States federal income tax liability of a U.S. holder if appropriate information is provided to the IRS. If a U.S. holder does not provide the appropriate party with the correct taxpayer identification number or any other proper document or certification required by the IRS (generally a Form W-9 in the case of a U.S. holder), such U.S. holder may be subject to penalties imposed by the IRS.

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THE FOREGOING DOES NOT PURPORT TO BE A COMPLETE ANALYSIS OF THE POTENTIAL TAX CONSIDERATIONS RELATING TO THE RIGHTS OFFERING AND IS NOT TAX ADVICE. THEREFORE, HOLDERS OF OUR COMMON STOCK ARE URGED TO CONSULT THEIR TAX ADVISORS AS TO THE SPECIFIC TAX CONSEQUENCES TO THEM OF THE RIGHTS OFFERING, INCLUDING THE APPLICABILITY OF FEDERAL, STATE, LOCAL, FOREIGN AND OTHER TAX LAWS.

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SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data presented below for the five years ended August 31, 2004 is derived from our consolidated financial statements and accompanying notes. This selected financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and accompanying notes thereto included elsewhere in this prospectus.

	Years Ended August 31,				
	2004	2003	2002	2001	2000
	(in thousands, except earnings (loss) per share)				
OPERATING RESULTS DATA:					
Net warehouse sales	$ 594,225	$ 638,485	$ 609,034	$ 473,127	$ 292,013
Export sales	1,052	7,039	2,361	500	421
Membership fees	8,768	8,335	8,911	11,553	7,433
Other income	5,655	6,838	8,222	1,585	783
Travel and auto programs					3,965
Total revenues	609,700	660,697	628,528	486,765	304,615
Cost of goods sold	513,781	565,731	517,464	403,536	256,652
Selling, general and administrative	104,850	104,419	93,138	70,613	53,439
Settlement and related expenses			1,720		
Goodwill amortization				998	223
Preopening expenses	584	2,366	2,213	4,866	7,681
Asset impairment and closure costs	6,714	11,736			
Operating income (loss)	(16,229)	(23,555)	13,993	6,752	(13,380)
Net interest and other income (expense)[1]	(8,259)	(8,797)	(7,016)	(3,114)	5,935
Income (loss) before (provision) benefit for income taxes, losses (including impairment charge in 2004) of unconsolidated affiliate and minority interest	(24,488)	(32,352)	6,977	3,638	(7,445)
(Provision) benefit for income taxes	(4,244)	(183)	4,647	586	119
Losses (including impairment charge in 2004) of unconsolidated affiliate	(4,828)[3]	(2,967)	(37)		
Minority interest	3,578	5,276	(152)	(840)	1,882
Preferred dividends	(3,360)	(1,854)	(991)		
Net income (loss) available (attributable) to common stockholders	$ (33,342)	$ (32,080)	$ 10,444	$ 3,384	$ (5,444)
EARNINGS (LOSS) PER SHARE COMMON STOCKHOLDERS					
Basic	$ (4.57)	$ (4.67)	$ 1.62	$ 0.54	$ (1.01)
Diluted	$ (4.57)	$ (4.67)	$ 1.55	$ 0.51	$ (1.01)

	As of August 31,				
	2004	2003	2002	2001	2000
	(in thousands)				
BALANCE SHEET DATA:					
Cash and cash equivalents	$ 34,410	$ 11,239	$ 22,057	$ 26,899	$ 24,503
Short-term restricted cash	7,255	7,180	4,048		
Marketable securities			3,015		5,482

Total assets	376,008	391,958	389,746	324,699	261,400
Long-term debt (including related party)	107,138	99,616	90,539	79,303	50,532
Stockholders equity	127,879	159,419	173,411	130,110	131,683
Dividends paid on common stock[2]					

(1) Net interest and other income (expense) includes interest income, gains and losses on sale of assets and interest on bank borrowings.

(2) We have has never declared a cash dividend on our common stock and do not anticipate doing so in the foreseeable future.

(3) Includes an impairment charge of $3.1 million.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis compares the results of operations for each of the three fiscal years ended August 31, 2004 and should be read in conjunction with the consolidated financial statements and the accompanying notes included elsewhere in this prospectus.

Our mission is to efficiently operate U.S.-style membership warehouse clubs in Latin America, the Caribbean, and the Philippines that sell high quality merchandise at low prices to our members and that provide fair wages and benefits to our employees as well as a fair return to our stockholders. We deliver quality imported U.S. brand-name and locally sourced products to our small business and consumer members in a warehouse club format that provides the highest possible value to our members. By focusing on providing exceptional value on quality merchandise in a low cost operating environment, we seek to grow sales volume and membership which in turn will allow for further efficiencies and price reductions and ultimately improved value to our members.

Our business consists primarily of international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. The number of warehouse clubs in operation, as of August 31, 2004 and August 31, 2003 and our ownership percentages and basis of presentation for financial reporting purposes by each country or territory are as follows:

Country/Territory	Number of Warehouse Clubs in Operation (as of August 31, 2004)	Number of Warehouse Clubs in Operation (as of August 31, 2003)	Ownership (as of August 31, 2004)	Basis of Presentation
Panama	4	4	100%	Consolidated
Costa Rica	3	3	100%	Consolidated
Dominican Republic	2	2	100%	Consolidated
Guatemala	2	2	66%	Consolidated
Philippines	4	3	52%	Consolidated
El Salvador	2	2	100%	Consolidated
Honduras	2	2	100%	Consolidated
Trinidad	2	2	90%	Consolidated
Aruba	1	1	90%	Consolidated
Barbados	1	1	100%	Consolidated
Guam		1	100%	Consolidated
U.S. Virgin Islands	1	1	100%	Consolidated
Jamaica	1	1	67.5%	Consolidated
Nicaragua	1	1	51%	Consolidated
Totals	26	26		
Mexico	3	3	50%	Equity
Grand Totals	29	29		

During fiscal 2004, we opened a new U.S.-style membership shopping warehouse club in the Philippines and closed our warehouse club in Guam. At the end of fiscal 2004, there were 26 consolidated warehouse clubs in operation, operating in 12 countries and one U.S. territory, in comparison to 26 consolidated warehouse clubs in operation, operating in 12 countries and two U.S. territories at the end of fiscal 2003, and 26 consolidated warehouse clubs operating in ten countries and two U.S. territories at the end of fiscal 2002. The average life of the 26 warehouse clubs in operation as of August 31, 2004 was 47 months. The average life of the 26 warehouse clubs in operation as of August 31, 2003 was 36 months. We anticipate opening a new warehouse club in San Jose, Costa Rica sometime in the second half of 2005. We have three additional warehouse clubs in Mexico as part of a 50/50 joint venture with Grupo Gigante, S.A. de C.V. as of the end of fiscal years 2004 and 2003.

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Net warehouse club sales decreased 6.9% to $594.2 million in fiscal 2004 from $638.5 million in fiscal 2003. Excluding $23.9 million in wholesale telephone card sales in the Philippines (which began in September of 2002 and were discontinued in May 2003) net warehouse club sales in fiscal 2004 decreased $20.4 million (3.3%) from adjusted fiscal 2003 sales of $614.6 million. Management believes net warehouse club sales excluding wholesale telephone card sales provides a better measure of ongoing operations and a more meaningful comparison of past and present operating results than total net warehouse sales because wholesale phone card sales were made only for a limited time, were discontinued in May 2003 and fell outside of our core business of operating international membership warehouse clubs. This reduction in net warehouse club sales was largely attributable to a reduction in wholesale business activity across our company, lower than anticipated holiday sales due to inadequate merchandise levels, and fewer warehouse clubs in operation for the full year. During the whole of fiscal 2004, we operated with an average of 1.5 fewer warehouse clubs as compared to the whole of fiscal 2003. The four warehouse clubs that were closed prior to the beginning of fiscal 2004 accounted for $62.4 million in net warehouse sales in fiscal 2003. The new warehouse clubs (three of which were opened during fiscal 2003 and only had a partial year s worth of sales in fiscal 2003, and one which was opened in the fourth quarter of fiscal 2004) accounted for an incremental $41.6 million in net warehouse sales in fiscal 2004 as compared to fiscal 2003. Net warehouse sales increased 4.8% in fiscal 2003 over fiscal 2002, or 0.9% excluding the telephone card sales. The increase of $5.6 million in net warehouse sales, excluding telephone card sales, resulted primarily from sales from three new warehouse clubs opened in fiscal 2003 and from a full 12 months of sales from four warehouse clubs that began operation in fiscal 2002.

Comparable warehouse club sales, which are for warehouse clubs open at least 12 full months, decreased 4.3% for the 53-week period ended September 5, 2004, compared to the same period last year. Excluding the wholesale telephone card sales, comparable warehouse club sales decreased 2.3%. Comparable warehouse club sales for the 52-week period ended August 31, 2003 decreased 2.9% compared to the same period in 2002. We have experienced improving comparable warehouse club sales during much of the second half of fiscal 2004 with the sales in warehouse clubs open at least 12 full months registering positive growth of 2.2% in June, 5.3% in July and 6.7% in August as compared to same month in the prior year.

Our warehouse club gross profit margins (defined as net warehouse club sales less associated cost of goods sold) for fiscal 2004 increased $2.0 million to $81.5 million, or 13.7% of net warehouse sales, from $79.5 million, or 12.5% of net warehouse sales, for fiscal 2003. The improvement in margin percent generally reflects improvements in the merchandise and operating efforts of our company during the year. Margins for the full year were positively impacted by reduced inventory shrink and lower markdowns as compared to the prior year, partially offset by costs incurred related to currency devaluations in certain markets during the year, most notably the Philippines and Nicaragua. Currency in the Dominican Republic has appreciated in the most recent quarter which largely offset the losses incurred in prior quarters and contributed to a fourth quarter margin of 14.4% of net warehouse sales. Fourth quarter margins in fiscal 2003 were 8.6% of net warehouse sales and were negatively impacted by markdowns associated with warehouse club closings during the period and write-downs associated with slow moving inventory of approximately $2.0 million. Our warehouse club gross profit margins for the full year of fiscal 2003 decreased as compared to fiscal 2002 by $14.3 million, resulting primarily from the previously noted charge of approximately $2.0 million related to slow-moving inventory, an 81% currency devaluation in the Dominican Republic, decrease of vendor rebates of $2.4 million over the prior fiscal year, lower merchandise selling prices, markdowns related to warehouse club closings in the fourth quarter of fiscal 2003 and overall lower sales than the same period of the prior year.

Export sales represent U.S. merchandise exported to our licensee warehouse clubs operating in Saipan, direct sales to third parties from our distribution centers and sales to PriceSmart Mexico, an unconsolidated affiliate (see Note 13-Related Party Transactions in the Notes to Consolidated Financial Statements included herein), which began in fiscal 2003. Export sales were $1.1 million in fiscal 2004 compared to $7.0 million in fiscal 2003. The decrease of $5.9 million was primarily due to decreased direct sales to third parties through our distribution centers which include sales to PriceSmart Mexico, an unconsolidated affiliate. Export sales were $7.0 million in fiscal 2003 compared to $2.4 million in fiscal 2002. The increase was primarily due to increased sales to PriceSmart Mexico during the period when its warehouse clubs were initially opened.

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Membership income, which is recognized into income ratably over the one-year life of the membership, increased 5.2% to $8.8 million, or 1.5% of net warehouse sales, in fiscal 2004 compared to $8.3 million, or 1.3% of net warehouse sales, in fiscal 2003. The increase in membership income reflects an increase in the average membership fee that we are charging in most locations. Total membership accounts as of the end of fiscal 2004 were approximately 436,000 compared to approximately 495,000 at the end of fiscal 2003. The 12% reduction in membership accounts in the past year is primarily due to the closure of two warehouse clubs (Guam and Eastside, Santo Domingo), the discontinuation of heavily discounted and complimentary memberships in Panama and Philippines, respectively, and the non-renewal, as of the end of August 2004, of a number of members who joined at the initial opening of the Nicaragua warehouse club in July 2003. In fiscal 2003, membership income decreased by 6.5% from fiscal 2002. The decrease is attributable to an overall lower membership fee structure in certain markets and reduced membership renewals. This decrease was partially offset by the three additional warehouse club openings in fiscal 2003, which increased the overall membership base from the end of fiscal 2002 to the end of fiscal 2003 by approximately 40,000 membership accounts.

Other income consists of commission revenue, rentals, advertising, merchandise demonstration income, construction revenue and fees earned from licensees. Other income, excluding license fees decreased $1.0 million in fiscal 2004 from fiscal 2003 to $4.6 million. The decrease is attributable to the discontinuation of certain promotional programs and a reduction in merchandise demonstration activity in fiscal 2004 as compared to fiscal 2003. License fees for fiscal 2004 were $1.1 million compared to $1.2 million in the prior year resulting primarily from our decision to not record income associated with our China licensee in the fourth quarter pending resolution of certain matters, including the payment of past due amounts. In October 2004, we concluded that, in view of the lack of substantive progress arising from the parties discussions regarding past-due payments to be made by the licensee to us under the PRC Technology License Agreement (Amended) entered into in February 2001, we should proceed with sending a notice of default relating to the licensee s non-payment. Accordingly, on October 7, 2004, we issued a notice of default to the licensee, demanding the payment of all due amounts within 30 days. The notice further advised that in the event payment is not timely made, we plan to terminate the PRC Technology License Agreement (Amended), as well as the PRC Trademark License Agreement which also has been entered into by us and the licensee. We did not receive timely payment, and as a result we terminated the PRC Technology License Agreement (Amended) and the PRC Trademark License by letter dated December 10, 2004. As a result of the above, we do not expect to receive royalties from our China licensee in future periods. Other income, excluding licensee fees, decreased to $5.6 million, in fiscal 2003 from $7.0 million in fiscal 2002. The decrease relates to less income earned primarily from merchandise demonstration income, which were substantially discontinued in May 2003, rentals, advertising (certain advertising revenues related to in-warehouse club advertising space were discontinued in the latter half of fiscal 2003) and construction revenues.

Warehouse operating expenses decreased to $81.8 million, or 13.8% of warehouse sales, for fiscal 2004 from $82.1 million, or 12.9% of warehouse sales, in fiscal 2003. The increase in operating expense as a percentage of net warehouse sales is attributable to lower net warehouse sales and an increase in utilities, repairs and maintenance, increased wage rates in certain warehouse club locations and increased costs with respect to credit card usage and fees. On average, the number of warehouse clubs in operation during fiscal 2004 was approximately 1.5 fewer than during fiscal 2003 which served to reduce overall spending, partially offsetting the specific increases noted above. We also recorded a $1.3 million charge related to the uncertainty concerning the ultimate recoverability of a prepaid asset in the Philippines in the fourth quarter of fiscal 2004. Warehouse club operating expenses increased to $82.1 million, or 12.9% of net warehouse sales, for fiscal 2003 from $74.3 million, or 12.2% of net warehouse sales, for fiscal 2002. The increase in warehouse club operating expenses is attributable to the three additional warehouse clubs opened in fiscal 2003 and a full year of operations from the four warehouse clubs opened throughout fiscal 2002.

General and administrative expenses increased to $23.1 million, or 3.9% of net warehouse sales, for fiscal 2004 from $22.3 million, or 3.5% of net warehouse sales, in fiscal 2003. We incurred $1.0 million in costs during the year for outside professional services attributable to legal proceedings arising from our restatement of financial results for fiscal year 2002 and the first three quarters of fiscal 2003. General and administrative expenses in fiscal 2004 also include a $0.6 million bad debt expense attributable to the outstanding receivable due from our China licensee for license fees billed in the second and third quarter of fiscal 2004. We incurred severance costs of $0.9 million during fiscal year 2004 (compared to $1.1 million in severance costs in fiscal 2003) and experienced increased insurance costs associated with workers compensation and director and officer liability as compared to fiscal 2003. Comparing fiscal year 2003 with fiscal year 2002, general and administrative expenses increased to $22.3 million, or 3.5% of net warehouse sales, from $18.9 million, or 3.1% of net warehouse sales. General and administrative expenses increased by approximately $3.4 million primarily as a result of increases in salaries, professional fees, severance of $1.1 million, stock compensation expense related to option repricing of approximately $1.0 million and a $350,000 charge related to the early termination of our foreign property insurance program.

Settlement and related expenses of $1.7 million in fiscal 2002 reflect a settlement agreement entered into with a former licensee on February 15, 2002 (see Note 10 Legal Settlement in the Notes to Consolidated Financial Statements included herein).

During fiscal 2004, we opened one warehouse club in Aseana City, Metro Manila, Philippines. We ended the fiscal year with four warehouse clubs operating in the Philippines. Expenses incurred before a warehouse club is in operation are captured in pre-opening expenses. In fiscal 2004 the pre-opening expenses associated with the one warehouse club opening were $584,000. In fiscal 2003, three new warehouse clubs were opened for a total cost of $2.4 million. Similarly, in fiscal 2002, we incurred $2.2 million in pre-opening expenses while opening four warehouse clubs.

Asset impairment and closure costs reflect the costs associated with the closure of warehouse clubs (including related severance payments), carrying costs of long-lived assets at previously closed warehouse club locations, and non-cash charges to properly reflect the book value of certain long lived assets or lease obligations based upon management s assessment of fair market value for those assets or liabilities. In fiscal 2004, we incurred $8.0 million in costs and non-cash charges, primarily related to either the cost of closing a warehouse club, an updated assessment as to the fair market value and future cash flows of previously closed warehouse locations, or the ongoing carrying costs of assets at those locations. The closing of our Guam location in the second fiscal quarter resulted in costs of $1.5 million, a reassessment of the estimated cash flows based upon market conditions for the previously closed Ortigas, Philippines location in the third fiscal quarter resulted in an additional non-cash charge of $3.8 million, and a similar review of the previously closed Guatemala location resulted in a non-cash charge in the fourth fiscal quarter of $0.5 million. We had previously recorded a $3.8 million charge in fiscal 2003 relating to closure of the Guatemala warehouse club at the time of the club s closing. Carrying costs for closed locations were $0.7 million for the fiscal year. We also recognized $166,000 in costs in connection with the closure of a west coast U.S. distribution center in the fourth quarter.

During fiscal 2003, we closed three warehouse clubs, one each in Dominican Republic, Philippines and Guatemala. The warehouse clubs were closed June 15, 2003, August 3, 2003 and August 15, 2003, respectively. The decision to close these warehouse clubs resulted from the determination that the locations were not conducive to the successful operation of our warehouse clubs. We recorded closure costs and asset impairment charges of $7.2 million related to those warehouse clubs closed as of August 31, 2003. The impairment charges of $1.9 million, included in the $7.2 million, reflected the difference between the carrying value and fair value of those long-lived assets that are not expected to be utilized at future warehouse club locations. During fiscal 2003, we also recorded non-cash asset impairment charges of $4.5 million to write down long-lived assets related to underperforming warehouse clubs in Guam and the United States Virgin Islands. The charges reflect the difference between the carrying value and fair value of those long-lived assets that are not expected to be utilized at future warehouse club locations.

Interest income primarily reflects earnings on cash, cash equivalent balances and restricted cash. Interest income was $2.4 million in fiscal 2004 and $2.9 million in fiscal 2003 and fiscal 2002.

Interest expense primarily reflects borrowings by our majority or wholly owned foreign subsidiaries to finance the capital requirements of new and existing warehouse clubs, and was $11.1 million for fiscal 2004 compared with $11.4 million and $10.0 million in fiscal 2003 and 2002, respectively. The changes in interest

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expense are a result of varied borrowings by us to finance the additional warehouse clubs opened during the periods.

Income from related party of $500,000 in fiscal 2004 relates to an incentive we received from our then landlord, Price Legacy Corporation, to terminate early the lease of our corporate headquarters. We moved to our new corporate headquarters in San Diego on March 26, 2004. Sol Price, a significant stockholder of our company, is also a principal stockholder of Price Legacy Corporation, and directors James F. Cahill, Murray L. Galinson and Jack McGrory serve on both companies boards of directors.

During fiscal 2004, we recognized a net deferred tax expense of $1.1 million, primarily related to the increase of valuation allowances for foreign deferred tax assets. We also incurred current income tax expense of $3.1 million (primarily related to our foreign operations, including provisions for probable income tax contingencies) for a net tax expense of $4.2 million. During fiscal 2003, we recognized a net deferred tax benefit of $640,000, primarily related to the reversal of a valuation allowance previously established against U.S. net deferred tax assets offset by increases in the valuation allowances for foreign deferred tax assets. We also incurred current income tax expense of $823,000 primarily related to our foreign operations for a net tax expense of $183,000 in fiscal 2003. During fiscal 2002, we recognized a net deferred tax benefit of $9.0 million, primarily related to the reversal of a partial release of the valuation allowance previously established against U.S. net deferred tax assets. We also incurred current income tax expense related to our foreign operations of $4.3 million, for a net tax benefit of $4.6 million in fiscal 2002.

Equity of unconsolidated affiliate represents our 50% share of losses from our Mexico joint venture. The joint venture is accounted for under the equity method of accounting, in which we reflect our proportionate share of income or loss. Losses from the Mexico joint venture in fiscal 2004 were $3.4 million of which our share was $1.7 million. During the fourth quarter of fiscal 2004, due to the historical operating losses and management s assessment as to the inability to recover the full carrying amount of its investment in PSMT Mexico, S.A. de C.V., we recorded a charge of $3.1 million to reduce our investment in unconsolidated affiliate. In fiscal 2003, the first year of operation, the Mexico joint venture had net losses of $5.9 million, of which our share was $3.0 million. Losses from the Mexico joint venture in fiscal 2002 were $74,000, of which our share was $37,000.

Minority interest relates to the allocation of the joint venture income or (loss) to the minority interest stockholders respective interests. Minority interest stockholders respective share of net losses was $3.6 million in fiscal 2004 compared to $5.3 million in fiscal 2003, and compared to income of $152,000 in fiscal 2002. In the fourth fiscal quarter of 2004, we began recording 100% of the loss of our Philippine subsidiary resulting from that subsidiary having offset the minority interest stockholders equity through accumulated losses. If the minority interest stockholders equity had been sufficient to continue offsetting accumulated losses in the Philippines, our fiscal year 2004 net loss would have been reduced by an additional $1.9 million in minority interest losses.

Preferred dividends of $3.4 million and $1.9 million reflect dividends paid or accrued on our preferred stock for fiscal years 2004 and 2003, respectively. In fiscal 2002, we issued 20,000 shares of Series A Preferred Stock on January 22, 2002, which accrued 8% annual dividends that were cumulative and payable in cash. In fiscal 2003, we issued 22,000 shares of Series B Preferred Stock on July 9, 2003, which accrued 8% annual dividends that were cumulative and payable in cash, and are subordinate to the Series A Preferred Stock. On September 5, 2003, we determined that we would not declare a dividend on the preferred stock. At end of fiscal 2004, we had approximately $3.9 million in accrued preferred dividends in other current liabilities. As described more fully in The Rights Offering Reasons for the Rights Offering, on October 29, 2004 and November 23, 2004, we issued shares of our common stock in exchange for all of our outstanding shares of Series B Preferred Stock and Series A Preferred Stock, respectively.

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Liquidity and Capital Resources

Financial Position and Cash Flow

We had a negative working capital position as of August 31, 2004 of $15.5 million, compared to a negative working capital position of $13.3 million as of August 31, 2003. Cash and cash equivalents increased $23.2 million, compared to the balance at August 31, 2003, largely as a result of a $25.0 million loan extended by The Price Group in conjunction with a proposed private placement of shares as part of the Financial Program described in Note 17- Subsequent Events of the Company s Consolidated Financial Statements.

Inventory levels at August 31, 2004 decreased $10.8 million from the prior year end, but are expected to rise in advance of the current holiday buying period. Accounts payable of $56.1 million as of the end of fiscal 2004 is $12.4 million below the prior year end. The reduction is due to lower inventory levels as well as reduced supplier credit terms from certain U.S. vendors. Many of these vendors are providing merchandise under pre-payment agreements whereby additional merchandise discounts are provided in exchange for pre-payment. The funding for this vendor arrangement is from a purchase order financing facility established in February 2004 and later amended in July 2004 with The Price Group for $15.0 million. This facility is included in accounts payable to and advances received from related party and had a balance (including accrued interest) of $15.2 million as of August 31, 2004. Also included in that account are the $5.1 million proceeds and accrued interest from an agreement entered into between us and The Price Group for the sale of the real estate and related leasehold improvements owned by our company in Santiago, Dominican Republic. The agreement was subject to several contingencies prior to completing the sale. As part of the Financial Program, on October 29, 2004 we issued The Price Group shares of common stock, valued for such purpose at $8 per share, in exchange for the repayment in full of all unpaid principal and interest associated with the purchase order financing agreement as well as the advance and accrued interest with respect to the intended (but subsequently cancelled) purchase of the parcel of real property in Santiago, Dominican Republic.

Our fiscal year 2004 net loss of $30.0 million included $24.0 million of non-cash charges such as depreciation, amortization, allowance for doubtful accounts, minority interest, losses in unconsolidated affiliate, compensation expense associated with stock options, and non-cash warehouse club closing and impairment charges. Inventories decreased by $10.8 million and accounts payable, including accounts payable to related parties, increased by $2.9 million, resulting in a net cash increase from these items of $13.8 million. The related party portion of that net cash increase was $15.3 million due to the purchase order financing fund established during the year. Without that facility, the change in working capital resulting from the net change in inventories and accounts payable would have been a negative $1.5 million. The resulting net cash flows provided by operating activities in fiscal 2004 was $14.0 million. For the year ended August 31, 2003, we had a net loss of $30.2 million which consisted of $23.9 million in non-cash charges such as depreciation, amortization, minority interest, losses in unconsolidated affiliate and non-cash warehouse club closing and impairment charges. Excluding non-cash charges, net cash provided by operating activities for the year ended August 31, 2003 primarily reflected decreases in accounts receivable of $5.6 million and inventories of $5.4 million resulting from the reduction in wholesale business sold on credit and warehouse club closings, respectively, and increases in accounts payable of $1.7 million. Net cash provided by operating activities for the year ended August 31, 2002 consisted of operating results before non-cash charges due to depreciation and amortization and reflect increases in inventory of $8.0 million offset partially by increases in accounts payable of $5.9 million due to new warehouse club openings, increase in accounts receivable of $5.9 million due to increased wholesale business, increases in prepaid assets of $3.3 million and deferred income taxes of $13.5 million resulting primarily from the reversal of a deferred tax asset valuation allowance.

In fiscal 2004, we received $5.0 million as an advance payment on the intended (but subsequently cancelled) sale of our property in Santiago, Dominican Republic. This cash inflow offset the outflows of $4.1 million during the year related to additions to property and equipment, including the opening of one warehouse club during the year in the Philippines, resulting in net cash provided by investing activities of $0.9 million. Net cash used in investing activities was $(29.2) million and $(49.2) million in fiscal 2003 and 2002, respectively. In

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those years, the investing activities related primarily to additions to property and equipment for new and existing warehouse clubs of $22.2 million and $34.4 million for fiscal 2003 and 2002, respectively. We (excluding Mexico) opened three and four warehouse clubs during fiscal 2003 and 2002, respectively. In fiscal 2003, we invested an additional $9.0 million in capital and loaned $1.0 million to the Mexico joint venture, and received $3.0 million from maturing marketable securities. In fiscal 2002, we invested $11.0 million in capital related to the Mexico joint venture, purchased marketable securities of $3.0 million, used $1.0 million for cash payments to holders of our common stock as make-whole payments in lieu of our obligation to redeem their shares upon request and used $500,000 to acquire the minority interest in Barbados.

With regards to financing activities, we received $30.0 million from related parties affiliated with the Prices. Of that amount, $25.0 million was received from the bridge loan that was converted to common stock, subsequent to August 31, 2004, as part of the Financial Program, and an additional $5.0 million was received from the proceeds of the sale of 500,000 shares of common stock. During fiscal year 2004, we used cash to reduce short-term borrowings by $7.4 million and made principal repayments on its various debt facilities of $15.4 million. For fiscal year 2004, net cash provided by financing activities was $11.0 million. In fiscal 2003, we received proceeds primarily from the sale of preferred stock for $22.0 million, an increase in net bank borrowings of $11.0 million, $2.4 million from the sale of treasury stock to PSC, S.A. in connection with the Nicaragua joint venture and $3.3 million in contributions by minority shareholders. Also, in fiscal 2003, we used approximately $10.2 million of restricted cash as security for debt agreements and paid preferred stock dividends of $1.6 million. In fiscal 2002, we received proceeds primarily from the sale of preferred stock and warrants for $19.9 million, $10.0 million from the sale of common stock, an increase in net bank borrowings of $14.8 million, contributions from minority interest shareholders and proceeds from stock options.

The net effect of exchange rate changes resulting from the translation of foreign subsidiary balance sheets on cash and cash equivalents was $(2.7) million, $(7.7) million and $(5.3) million in fiscal 2004, 2003 and 2002, respectively. The negative foreign exchange impact has resulted primarily from a significant devaluation of the Dominican Republic Peso and by continued devaluations of the foreign currencies in most of the countries where we operate, which have all historically devalued against the U.S. dollar. As a result of the instability in the Dominican Republic, there continues to be a risk of further devaluation and availability of U.S. dollars to settle intercompany transactions.

Financing Activities

On January 22, 2002, we issued 20,000 shares of Series A Preferred Stock and warrants to purchase 200,000 shares of common stock (that expired unexercised on January 17, 2003) for an aggregate of $20.0 million, with net proceeds of $19.9 million (See Note 13 Related Party Transactions and Note 14 Convertible Preferred Stock and Warrants in the Notes to Consolidated Financial Statements included herein). The Series A Preferred Stock was convertible, at the option of the holder at any time, or automatically on January 17, 2012, into shares of our common stock at the conversion price of $37.50, subject to customary anti-dilution adjustments. The Series A Preferred Stock accrued a cumulative preferred dividend at an annual rate of 8%, payable quarterly in cash. The shares were redeemable on or after January 17, 2007, in whole or in part, at our option, at a redemption price equal to the liquidation preference or $1,000 per share plus accumulated and unpaid dividends to the redemption date. As of August 31, 2004, none of the shares of the Series A Preferred Stock had been converted. However, as announced on September 3, 2004 and subsequently approved by our stockholders at a special meeting of stockholders held on October 29, 2004, we offered to exchange shares of common stock, valued for such purpose at $10 per share, in exchange for all of the outstanding shares of our Series A Preferred Stock, together with accrued and unpaid dividends thereon. The exchange period ended November 23, 2004, and, as described above under The Rights Offering Reasons for the Rights Offering, all holders of Series A Preferred Stock tendered their shares for exchange. As a result, no shares of Series A Preferred Stock are outstanding.

On July 9, 2003, the Prices, purchased an aggregate of 22,000 shares of Series B Preferred Stock, a new series of preferred stock, for an aggregate purchase price of $22.0 million. The Series B Preferred Stock was

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convertible at the option of the holder at any time, or automatically on July 9, 2013, into shares of our common stock at a conversion price of $20.00 per share, subject to customary anti-dilution adjustments; accrued a cumulative preferential dividend at an annual rate of 8%, payable quarterly in cash; and was redeemable by us at any time on or after July 9, 2008. As of August 31, 2004, none of the shares of the Series B Preferred Stock had been converted. However, as announced on September 3, 2004 and subsequently approved by our stockholders at a special meeting of stockholders held on October 29, 2004, we issued on that same date common stock, valued for such purpose at $10 per share in exchange for all of the outstanding shares of our Series B Preferred Stock. We agreed to register with the SEC the shares of common stock issuable upon exchange of the Series B Preferred Stock.

On September 5, 2003, we determined we would not declare a dividend on the Series A Preferred Stock for the fourth quarter of 2003. Also, no dividends were to be declared or paid on the Series B Preferred Stock until full cumulative dividends have been declared and paid on the Series A Preferred Stock. Instead, dividends on the Series A Preferred Stock and the Series B Preferred Stock accrued in accordance with the terms of the Certificates of Designations for the Series A Preferred Stock and the Series B Preferred Stock.

On October 22, 2003, The Price Group purchased an aggregate of 500,000 shares of our common stock, for an aggregate purchase price of $5.0 million. Directors Robert E. Price, James F. Cahill, Murray L. Galinson and Jack McGrory are co-managers of The Price Group and collectively own a significant interest in that entity.

In February 2004, we entered into an agreement with The Price Group to provide up to $10.0 million of purchase order financing. The agreement was amended in July 2004 to provide an additional $5.0 million of purchase order financing. This agreement allowed The Price Group to place a lien on merchandise inventories in the United States. The amended agreement also placed a lien on our shares in our wholly-owned Panamanian subsidiary, PriceSmart Real Estate Panama, S.A. In May 2004, we entered into an agreement with The Price Group to sell the real estate and improvements owned by our company in Santiago, Dominican Republic. The purchase price was to be the fair market value of the property and improvements as determined by an independent appraiser. Under terms of the agreement, The Price Group made an initial payment of $5.0 million. As part of the Financial Program, on October 29, 2004, we issued The Price Group 2,606,321 shares of common stock, valued for such purpose at $8 per share, in exchange for the repayment in full of all unpaid principal and interest associated with the purchase order financing agreement as well as the advance and accrued interest with respect to the intended (but subsequently cancelled) purchase of the parcel of real property in Santiago, Dominican Republic.

In August 2004, we entered into a $25.0 million bridge loan with The Price Group. This loan accrued interest at 8% per annum and was due in two years. As part of the Financial Program, on October 29, 2004, we issued The Price Group 3,170,205 shares of common stock, valued for such purpose at $8 per share, in a private placement funded through the conversion of the bridge loan, together with accrued and unpaid interest thereon.

Short-Term Borrowings and Long-Term Debt

As of August 31, 2004, we, together with our majority or wholly owned subsidiaries, had $13.4 million outstanding in short-term borrowings, which are secured by certain assets of our company and our subsidiaries and are guaranteed by us up to our respective ownership percentage. Each of the facilities expires during fiscal year 2005 and typically is renewed. As of August 31, 2004, we had $6.3 million available on these facilities.

Our long-term debt is collateralized by certain land, building, fixtures, equipment and shares of each respective subsidiary and guaranteed by us up to our respective ownership percentages and approximately $28.4 million as of August 31, 2004, is secured by collateral deposits included in restricted cash on the balance sheet. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.

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Under the terms of debt agreements to which we and/or one or more of our wholly owned or majority owned subsidiaries are parties, we must comply with specified financial maintenance covenants, which include among others, current, debt service, interest coverage and leverage ratios. As of August 31, 2004, we were in compliance with all of these covenants, except for the following: (i) current ratio and cash flow to debt service and projected debt service ratio for a $5.0 million note (with a remaining balance of $4.1 million), however, we repaid the remaining balance of this note on September 15, 2004; (ii) debt service ratio for a $11.3 million note (with a remaining balance of $2.6 million), for which we have requested, but not yet received, a written waiver of our noncompliance; (iii) interest cost/EBIT (earnings before interest and taxes) ratio for a $6.0 million note (with a remaining balance of $4.0 million), for which we have requested, but not yet received, a written waiver of our noncompliance; and (iv) debt to equity ratio for a $7.0 million note (with a remaining balance of $3.9 million), for which we have requested, but not yet received, a written waiver. For the waivers requested, but not yet received, we believe that the waivers will be approved as of August 31, 2004 and will be waived for a period of one quarter. Additionally, we have debt agreements, with an aggregate principal amount outstanding as of August 31, 2004 of $27.9 million that, among other things, allow the lender to accelerate the indebtedness upon a default by us under other indebtedness and prohibit us from incurring additional indebtedness unless we are in compliance with specified financial ratios. As of August 31, 2004, we did not satisfy these ratios. As a result, we are prohibited from incurring additional indebtedness and would need to obtain a waiver from the lender as a condition to incurring additional indebtedness. If we are unsuccessful in obtaining the necessary waivers or fail to comply with these financial covenants in future periods, the lenders may elect to accelerate the indebtedness described above and foreclose on the collateral pledged to secure the indebtedness. We believe that, primarily as a result of the Financial Program described in Note 17 Subsequent Events in its Consolidated Financial Statements, we have sufficient financial resources to meet our working capital and capital expenditure requirements during fiscal year 2005.

Contractual Obligations

As of August 31, 2004, our commitments to make future payments under long-term contractual obligations were as follows (in thousands):

	Payments Due by Period				
Contractual obligations	**Total**	**Less than 1 Year**	**1 to 3 Years**	**4 to 5 Years**	**After 5 Years**
Long-term debt	$ 123,641	$ 16,503	$ 53,129	$ 22,793	$ 31,216
Operating leases	131,958	9,480	18,052	17,131	87,295
Total	$ 255,599	$ 25,983	$ 71,181	$ 39,924	$ 118,511

Critical Accounting Estimates

The preparation of our financial statements requires that management make estimates and judgments that affect the financial position and results of operations. Management continues to review its accounting policies and evaluate its estimates, including those related to merchandise inventory and impairment of long-lived assets. We base our estimates on historical experience and on other assumptions that management believes to be reasonable under the present circumstances.

Merchandise Inventories: Merchandise inventories, which include merchandise for resale, are valued at the lower of cost (average cost) or market. We provide for estimated inventory losses and obsolescence between physical inventory counts on the basis of a percentage of sales.

The provision is adjusted periodically to reflect the trend of actual physical inventory count results, which occur primarily in the second and fourth fiscal quarters. In addition, we may be required to take markdowns below the carrying cost of certain inventory to expedite the sale of such merchandise.

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Impairment of Long-lived Assets: We periodically evaluate our long-lived assets for indicators of impairment. Management s judgments are based on market and operational conditions at the time of the evaluation. Future events could cause management to conclude that impairment factors exist, requiring an adjustment of these assets to their then-current fair market value. Future circumstances may result in our actual future closing costs or the amount recognized upon the sale of the property differing substantially from the estimates.

Allowance for Bad Debt: Credit is extended to a portion of our members as part of our wholesale business and to third-party wholesalers for direct sales. We maintain an allowance for doubtful accounts based on assessments as to the collectibility of specific customer accounts, the aging of accounts receivable, and general economic conditions. Additionally, we formerly utilized the importation and exportation businesses of one of the minority interest shareholders in our Philippines subsidiary for the movement of merchandise inventories both to and from the Asian regions. As of August 31, 2004, we had a total of approximately $645,000 in net receivables due from the minority interest shareholder s importation and exportation businesses, which is included in accounts receivable on the consolidated financial statements. If the credit worthiness of a specific customer or the minority interest shareholder deteriorates, our estimates could change and it could have a material impact on our reported results.

Stock-Based Compensation: As of August 31, 2004, we had four stock-based employee compensation plans. Beginning September 1, 2002, we adopted the fair value based method of recording stock options contained in Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, which is considered the preferable accounting method for stock-based employee compensation. Beginning September 1, 2002, all future employee stock option grants will be expensed over the stock option vesting period based on the fair value at the date the options are granted. Historically, and through August 31, 2002, we have applied Accounting Principles Board Opinion No. 25 and related interpretations in accounting for its stock option plans.

Deferred Taxes: A valuation allowance is recorded to reduce deferred tax assets to the amount that is more likely than not to be realized. As of August 31, 2004, we evaluated our deferred tax assets and liabilities and determined that, in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, a valuation allowance is necessary for certain foreign deferred tax asset balances, primarily because of the existence of significant negative objective evidence, such as the fact that certain countries are in a cumulative loss position for the past three years.

We have a federal and state tax net operating loss carry-forward at August 31, 2004 of approximately $40.5 million and $6.7 million, respectively. In calculating the tax provision, and assessing the likelihood that we will be able to utilize the deferred tax assets, we considered and weighed all of the evidence, both positive and negative, and both objective and subjective. We factored in the inherent risk of forecasting revenue and expenses over an extended period of time and considered the potential risks associated with our business. Because of our history of U.S. income and based on projections of future taxable income in the U.S., we were able to determine that there was sufficient positive evidence to support the conclusion that it was more likely than not that we would be able to realize the U.S. deferred tax assets by generating taxable income during the carry-forward period. However, due to their shorter recovery period, we have maintained valuation allowances on U.S. Foreign Tax Credits and Capital Loss Carryforwards.

As a result of significant losses in many of our foreign subsidiaries at August 31, 2004, we have concluded that full valuation allowances are necessary in all but two of our subsidiaries. We have factored in the inherent risk of forecasting revenue and expenses over an extended period of time and also considered the potential risks associated with our business. There was not sufficient positive evidence to overcome the existence of the negative objective evidence of cumulative losses. As a result, management concluded that it was more likely than not that the deferred tax assets would not be realized in all but two of its subsidiaries.

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Basis of Presentation: The consolidated financial statements include the assets, liabilities and results of operations of our majority and wholly owned subsidiaries that are more than 50% owned and controlled. All significant intercompany balances and transactions have been eliminated in consolidation. Our 50% owned Mexico joint venture is accounted for under the equity method of accounting.

Accounting Pronouncements

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The principal difference between SFAS 146 and Issue 94-3 relates to SFAS 146 s requirements for recognition of a liability for a cost associated with an exit or disposal activity. SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recorded as a liability when incurred. Under Issue 94-3, a liability for an exit cost as generally defined in Issue 94-3 was recognized at the date of an entity s commitment to an exit plan. The provisions of this statement are effective for exit or disposal activities that are initiated after December 31, 2002 with early application encouraged. We recorded closure costs of $3.5 million and $5.3 million in fiscal years 2004 and 2003, respectively (See Note 8 Asset Impairment Charges and Closure Costs in the Notes to Consolidated Financial Statements included herein).

In January, 2003, the FASB issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51, or ARB 51. FASB Interpretation No. 46 was revised in December 2003 and clarifies the application of ARB 51 to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The application of FASB Interpretation No. 46 may require that an entity be subject to consolidation even though the investor does not have a controlling financial interest that, under ARB 51, was usually deemed to exist through ownership of a majority voting interest. FASB Interpretation No. 46, as revised, is generally effective for all entities subject to the interpretation no later than the end of the first reporting period that ends after March 15, 2004. The adoption of this interpretation did not have an impact on our consolidated results of operations, financial position or cash flows.

Emerging Issues Task Force Issue No. 02-16, which we refer to as EITF 02-16, Accounting by a Customer (Including a Reseller) for Certain Consideration Received by a Vendor, addresses how a reseller should account for cash consideration received from a vendor. Under this provision, effective for arrangements entered into or modified after December 31, 2002, cash consideration received from a vendor is generally presumed to be a reduction of the prices of the vendor s products and, therefore, should be characterized as a reduction of these costs. The adoption of the provisions of EITF 02-16 did not result in any changes in our reported net income, but certain consideration which had been classified as other income in prior years is now reflected as a reduction of cost of sales. As permitted by the transition provisions of EITF 02-16, other income and cost of sales in prior periods have been reclassified to conform to the current period presentation. This resulted in a decrease in other income and an offsetting decrease in net warehouse cost of goods sold of $688,000, $1.1 million and $3.5 million in fiscal 2004, 2003 and 2002, respectively.

Emerging Issues Task Force Issue No. 03-10, which we refer to as EITF 03-10, Application of Issue No. 02-16 by Resellers to Sales Incentives Offered to Consumers by Manufacturers, provides guidance for the reporting of vendor consideration received by a reseller as it relates to manufacturers incentives (such as rebates or coupons) tendered by consumers. Vendor consideration may be included in revenues only if defined criteria are met; otherwise, such consideration would be recorded as a decrease in cost of goods sold. The provisions of EITF 03-10 became effective for transactions entered into by consumers in fiscal periods beginning after November 25, 2003 and, therefore apply to transactions starting with our second fiscal quarter of 2004. The adoption of EITF 03-10 did not affect our consolidated gross profit or net loss, as there was not a material impact on the consolidated financial statements.

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Quantitative and Qualitative Disclosures about Market Risk

We, through majority or wholly owned subsidiaries, conduct operations primarily in Latin America, the Caribbean and Asia, and as such are subject to both economic and political instabilities that cause volatility in foreign currency exchange rates or weak economic conditions. As of August 31, 2004, we had a total of 26 consolidated warehouse clubs operating in 12 foreign countries and one U.S. territory (excluding the three warehouse clubs owned in Mexico through its 50/50 joint venture). Nineteen of the 26 warehouse clubs operate under currencies other than the U.S. dollar. For fiscal 2004, approximately 78% of our net warehouse sales were in foreign currencies. We may enter into additional foreign countries in the future or open additional locations in existing countries, which may involve similar economic and political risks as well as challenges that are different from those currently encountered. Foreign currencies in most of the countries where we operate have historically devalued against the U.S. dollar and are expected to continue to devalue. For example, the Dominican Republic experienced a currency devaluation of approximately 81% between the end of the fiscal year ended August 31, 2002 and the end of the year ended August 31, 2003 and 13% (significantly higher at certain points of the year) between the year ended August 31, 2003 and the year ended August 31, 2004. There can be no assurance that we will not experience any other materially adverse effects on our business, financial condition, operating results, cash flow or liquidity, from currency devaluations in other countries, as a result of the economic and political risks of conducting an international merchandising business.

Foreign exchange transaction losses realized, which are included as a part of the costs of goods sold in the consolidated statement of operations, for fiscal 2004, 2003 and 2002 were approximately $579,000, $605,000 and $1.2 million, respectively. Translation adjustments (losses) from our share of non-U.S. dollar denominated majority or wholly owned subsidiaries and investment in affiliate, resulting from the translation of assets and liabilities of the subsidiaries and affiliate into U.S. dollars, were $4.3 million and $7.7 million as of August 31, 2004 and 2003, respectively.

The following is a listing of each country or territory where we currently operate and their respective currencies, as of August 31, 2004:

Country/Territory	Number of Warehouse Clubs In Operation	Currency
Panama	4	U.S. Dollar
Costa Rica	3	Costa Rican Colon
Philippines	4	Philippine Peso
Mexico*	3	Mexican Peso
Dominican Republic	2	Dominican Republic Peso
Guatemala	2	Guatemalan Quetzal
El Salvador	2	U.S. Dollar
Honduras	2	Honduran Lempira
Trinidad	2	Trinidad Dollar
Aruba	1	Aruba Florin
Barbados	1	Barbados Dollar
Guam		U.S. Dollar
U.S. Virgin Islands	1	U.S. Dollar
Jamaica	1	Jamaican Dollar
Nicaragua	1	Nicaragua Cordoba Oro
Totals	29	

* Warehouse clubs are operated through a 50/50 joint venture, which is accounted for under the equity method.

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We are exposed to changes in interest rates on various debt facilities. A hypothetical 100 basis point adverse change in interest rates along the entire interest rate yield curve would adversely affect our pretax net loss (excluding any minority interest impact) by approximately $600,000.

Philippines Sales Trends and Projected Losses

Our Philippines operations, consisting of four warehouse clubs in Metro Manila (along with one former and currently unoccupied warehouse club), are performing well below management s expectation, with sales growth below plan, resulting in operating losses and negative cash flow over the past year (including the most recent fiscal quarter). We believe that two primary reasons for these results are: (i) the business has not been adequately capitalized; and (ii) the distribution of U.S. merchandise to the Philippines has not been maintained at a sufficiently consistent level. Recently, we were experiencing significant difficulties with the timely customs clearance of U.S. merchandise which has had a negative impact on the business in the near term. However, we continue to believe that the Philippines could be a viable and profitable market for our company and we continue our efforts to improve the business there. There is no guarantee, however, that our company will be successful in these efforts, and operating losses and negative cash flow could continue for the foreseeable future.

Public Company Compliance Costs and Considerations

We incur certain costs associated with being a publicly traded company. Beginning with fiscal year 2005, the direct and indirect costs associated with Sarbanes-Oxley Section 404 compliance will add significantly to that cost. The expenses associated with implementing the additional processes and procedures necessary for Section 404 compliance and the fiscal year 2005 required attestation of those controls have been estimated at approximately $1.7 million, approximately three times the entire cost of the fiscal 2004 year end audit. The cost of initial implementation and on-going compliance is particularly high for us due to the multiple geographic areas in which we operate (12 countries and one U.S. territory). Moreover, Section 404 compliance will inevitably result in a diversion of management time and attention from other duties.

We are monitoring the cost of operating as a public company to determine whether in our judgment the direct and indirect costs outweigh the benefits to us and our stockholders. If we conclude as a result of this review that these costs, including but not limited to the new costs of compliance with Section 404, outweigh the benefits of remaining as a publicly reporting company, management and the board of directors may, over the next several months, begin to consider alternatives to remaining a public company. We understand that several other companies are evaluating similar questions. Alternatives that we could consider and evaluate would include:

- a going private transaction;
- a sale or merger of the business; or
- selling significant parts of the business and taking the remainder private.

While we sometimes have engaged in discussions with minority partners in some locations as to sales of those locations, we have not engaged in any substantive discussions regarding these alternatives with any affiliated or unaffiliated third parties nor have we retained investment bankers, appraisers or other advisors. We do not know whether if we were to engage in any exploration of alternatives that we would be able to find any potential acquirer that would be willing to buy our company at a price that our board of directors and stockholders would find acceptable. Consequently, while we believe it may become appropriate to consider the possibility of such a transaction, we are not in a position to evaluate the likelihood that any such proposal will be made or, even if a proposal were to be made, whether a transaction would be consummated. Any such proposal would depend on a number of factors at a future time, including our business and prospects, our operating and financial performance in the interim and the market price for our securities.

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BUSINESS

Our business consists primarily of international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. The number of warehouse clubs in operation, as of August 31, 2004 and August 31, 2003, our ownership percentages and basis of presentation for financial reporting purposes by each country or territory are as follows:

Country/Territory	Number of Warehouse Clubs in Operation (as of August 31, 2004)	Number of Warehouse Clubs in Operation (as of August 31, 2003)	Ownership (as of August 31, 2004)	Basis of Presentation
Panama	4	4	100%	Consolidated
Costa Rica	3	3	100%	Consolidated
Dominican Republic	2	2	100%	Consolidated
Guatemala	2	2	66%	Consolidated
Philippines	4	3	52%	Consolidated
El Salvador	2	2	100%	Consolidated
Honduras	2	2	100%	Consolidated
Trinidad	2	2	90%	Consolidated
Aruba	1	1	90%	Consolidated
Barbados	1	1	100%	Consolidated
Guam		1	100%	Consolidated
U.S. Virgin Islands	1	1	100%	Consolidated
Jamaica	1	1	67.5%	Consolidated
Nicaragua	1	1	51%	Consolidated
Totals	26	26		
Mexico	3	3	50%	Equity
Grand Totals	29	29		

During fiscal 2004, we opened a new U.S.-style membership shopping warehouse club in the Philippines and closed our warehouse club in Guam. At the end of fiscal 2004, the total number of consolidated warehouse clubs in operation was 26, operating in 12 countries and one U.S. territory in comparison to 26 warehouse clubs operating in 12 countries and two U.S. territories at the end of fiscal 2003, and 26 consolidated warehouse clubs operating in ten countries and two U.S. territories at the end of fiscal 2002. The average life of the 26 warehouse clubs in operation as of August 31, 2004 was 47 months. The average life of the 26 warehouse clubs in operation as of August 31, 2003 was 36 months. We anticipate opening a new warehouse club in San Jose, Costa Rica sometime in the second half of 2005. We had three additional warehouse clubs in Mexico as part of a 50/50 joint venture with Grupo Gigante, S.A. de C.V. as of the end of fiscal years 2004 and 2003.

In addition to the warehouse clubs operated directly by us or through our joint ventures, there were 12 warehouse clubs in operation (11 in China and one in Saipan, Micronesia) licensed to and operated by local business people, through which we had been primarily earning a licensee fee on a per warehouse club basis (see International Licensee Business), at the end of fiscal 2004, compared to 14 licensed warehouse clubs at the end of fiscal 2003.

Between our spin-off from Price Enterprises, Inc. in 1997 and 2001, we also operated a travel program that offered discounted prices on airline tickets, cruises, travel packages, car rentals and hotels, primarily to Costco, Inc. members; operated an auto referral business; held certain city notes receivable; and held real property that was available for sale.

International Warehouse Club Business

We own and operate U.S.-style membership shopping warehouse clubs through majority or wholly owned ventures operating in Latin America, the Caribbean and Asia using the trade name PriceSmart. The warehouse clubs sell basic consumer goods, to individuals and businesses, typically comprised of approximately 45% U.S.-sourced merchandise and approximately 55% locally sourced merchandise, with an emphasis on quality and low prices. By offering low prices on brand name and private label merchandise, the warehouse clubs seek to generate sufficient sales volumes to operate profitably at relatively low gross profit margins. The typical no-frills warehouse club-type buildings range in size from 40,000 to 50,000 square feet of selling space and are located primarily in urban areas to take advantage of dense populations and relatively higher levels of disposable income. Product selection includes perishable foods and basic consumer products. Ancillary services include food services, bakery, tire centers, photo centers, pharmacy and optical departments. The shopping format generally includes an annual membership fee of approximately $25.

Typically, when entering a new market we enter into licensing and technology transfer agreements with a newly created joint venture company (in which we are the majority stockholder and whose minority stockholders are local business people) pursuant to which we provide our know-how package, which includes training and management support, as well as access to our computer software systems and distribution channels. The license also includes the right to use the PriceSmart mark and certain other trademarks. We believe that the local business people have been interested in entering into such joint ventures and obtaining such licenses for a variety of reasons, including the successful track record of our management team and our smaller format membership clubs, the opportunity to purchase U.S.-sourced products, the benefits of our modern distribution techniques and the opportunity to obtain exclusive rights to use our trademarks in the region.

Business Strategy

Our mission is to efficiently operate U.S.-style membership warehouse clubs in Latin America, the Caribbean, and the Philippines that sell high quality merchandise at low prices to our members and that provide fair wages and benefits to our employees as well as a fair return to our stockholders. We deliver quality imported U.S. brand-name and locally sourced products to its small business and consumer members in a warehouse club format that provides the highest possible value to its members. By focusing on providing exceptional value on quality merchandise in a low cost operating environment, we seek to grow sales volume and membership which in turn will allow for further efficiencies and price reductions and ultimately improved value to our members.

Membership Policy

Our membership fee structure was specifically designed to allow pricing flexibility from country to country. We believe that membership reinforces customer loyalty. In addition, membership fees provide a continuing source of revenue. We have two primary types of members: Business and Diamond (individual).

Business owners and managers qualify for Business membership. We promote Business membership through our merchandise selection and our marketing programs primarily targeting wholesalers, institutional buyers and retailers. Business members pay an annual membership fee which approximates $25 for a primary and spouse membership card and approximately $12 for additional add-on membership cards. Individual members pay an annual membership fee which approximates $25 and an approximate fee of $12 for an add-on membership card.

We recognize membership fee revenues over the term of the membership, which is 12 months. Deferred revenue is presented separately on the face of the balance sheet and totaled $4.2 million and $4.1 million as of August 31, 2004 and 2003, respectively. Our membership agreements contain an explicit right to refund if our customers are dissatisfied with their membership. Our historical rate of membership fee refunds has been approximately 0.5% of membership income, or approximately $45,000, $42,000 and $45,000 for each of the years ended August 31, 2004, 2003 and 2002, respectively.

Expansion Plans

In the past, we have rapidly expanded into new countries and markets as part of our strategy to gain volume buying benefits and to move quickly into underserved areas. We are currently focusing our management attention

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on improving the operations of our current locations and believe that our existing portfolio provides the opportunity for improved sales and profitability. However, we continue to identify and evaluate various options for expansion, particularly in the countries in which we have already established a strong market presence. In that regard, we recently announced that we have acquired land in San Jose, Costa Rica for the future construction of a fourth warehouse club in that country.

Warehouse Club Closings and Asset Impairment

During fiscal 2003, we closed three warehouse clubs, one each in Dominican Republic, Ortigas, Metro Manila, Philippines and Guatemala. We also closed our warehouse club in Guam on December 24, 2003 and our Commerce, California distribution center on August 31, 2004. The decision to close the warehouse clubs resulted from the determination that the locations were not conducive to the successful operation of one of our warehouse clubs.

As a result of the closures mentioned above, during fiscal 2003, we recorded closure costs and impairment charges of $7.2 million related to those warehouse clubs closed as of August 31, 2003. Impairment charges of $1.9 million were included in the $7.2 million, reflecting the difference between the carrying value and the fair value of those long-lived assets (building improvements and fixtures and equipment) that were not expected to be utilized at future warehouse club locations. Also during fiscal 2003, we recorded non-cash asset impairment charges of $4.5 million to write-down long-lived assets related to underperforming warehouse clubs in Guam (subsequently closed in fiscal 2004) and the United States Virgin Islands. These charges also reflected the difference between the carrying value and fair value of those long-lived assets that were not expected to be utilized at future warehouse club locations. The fair value of long-lived assets was based on estimated selling prices for similar assets.

During fiscal 2004, we recorded approximately $3.5 million of additional closure costs related to the four closed warehouse clubs and one closed distribution center. We also recorded approximately $3.2 million in non-cash impairment charges related to the write-down of the carrying value of the building at the closed warehouse club in the Philippines. This charge results from revised cash flow estimates regarding the marketability of the land and building for this location. The original estimate regarding the market price of leasing these assets was derived from negotiations that discontinued during the second quarter of fiscal 2004. At that time, we believed the price being offered was a reasonable estimate of market value. However, during the third quarter an offer was received at a significantly lower price; therefore, we revised our estimates downward.

During the fourth quarter of fiscal 2004, due to the historical operating losses and management s assessment as to the inability to recover the full carrying amount of our investment in PSMT Mexico, S.A. de C.V., we recorded charge of $3.1 million to reduce our investment in unconsolidated affiliate. We are a 50% shareholder in PSMT Mexico, S.A. de C.V. and account for our investment under the equity accounting method.

International Licensee Business

We had 12 warehouse clubs in operation (11 in China and one in Saipan, Micronesia) licensed to and operated by local business people at the end of fiscal 2004, through which we had been primarily earning license fees on a per warehouse club basis, and also earned other fees in connection with certain licensing and technology transfer agreements and sales of products purchased from us.

During the second fiscal quarter of 2004, representatives of our company and our China licensee held discussions with regards to payments to be made by the licensee to us under the PRC Technology License Agreement (Amended) entered into in February 2001. In this regard, the licensee failed to satisfy certain of these payment obligations, asked us to relieve it from some of the payment obligations and sought related modifications to the parties relationship. During the pendency of the parties discussions, we agreed to a temporary moratorium on certain payment obligations. In October 2004, we concluded that, in view of the lack of substantive progress arising from the parties discussions, we should proceed with sending a notice of default relating to the licensee s non-payment. Accordingly, on October 7, 2004, we issued a notice of default to the

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licensee, demanding the payment of $1,403,845 within 30 days for previously unbilled license fees and interest. We did not receive timely payment. Accordingly, we terminated the PRC Technology License Agreement (Amended), as well as the PRC Trademark License Agreement which we have also entered into with the licensee, by letter dated December 10, 2004. As a result of the above, we have fully reserved the outstanding receivable by recording a bad debt expense of $0.6 million and did not record revenue from this license relationship in the fourth quarter.

Intellectual Property Rights

It is our policy to obtain appropriate proprietary rights protection for trademarks by filing applications for registrable marks with the U.S. Patent and Trademark Office, and in certain foreign countries. In addition, we rely on copyright and trade secret laws to protect our proprietary rights. We attempt to protect our trade secrets and other proprietary information through agreements with our joint venturers, employees, consultants and suppliers and other similar measures. There can be no assurance, however, that we will be successful in protecting our proprietary rights. While management believes that our trademarks, copyrights and other proprietary know-how have significant value, changing technology and the competitive marketplace make our future success dependent principally upon its employees technical competence and creative skills for continuing innovation.

There can be no assurance that third parties will not assert claims against us with respect to existing and future trademarks, trade names, sales techniques or other intellectual property matters. In the event of litigation to determine the validity of any third-party s claims, such litigation could result in significant expense to us and divert the efforts of our management, whether or not such litigation is determined in our favor.

While we have registered under various classifications the mark PriceSmart in several countries, certain registration applications remain pending; because of objections by one or more parties, there can be no assurance that we will obtain all such registrations or that we have proprietary rights to the marks.

In August 1999, our company and Associated Wholesale Grocers, Inc. entered into an agreement regarding the trademark PriceSmart and related marks containing the name PriceSmart. We have agreed not to use the PriceSmart mark or any related marks containing the name PriceSmart in connection with the sale or offer for sale of any goods or services within Associated Wholesale Grocers territory of operations, including the following ten states: Kansas, Missouri, Arkansas, Oklahoma, Nebraska, Iowa, Texas, Illinois, Tennessee and Kentucky. We however, may use the mark PriceSmart or any mark containing the name PriceSmart on the internet or any other global computer network whether within or outside such territory, and in any national advertising campaign that cannot reasonably exclude the territory, and we may use the mark in connection with various travel services. Associated Wholesale Grocers has agreed not to oppose any trademark applications filed by us for registration of the mark PriceSmart or related marks containing the name PriceSmart, and Associated Wholesale Grocers has further agreed not to bring any action for trademark infringement against us based upon our use outside the territory (or with respect to the permitted uses inside the territory) of the mark PriceSmart or related marks containing the name PriceSmart.

Employees

As of August 31, 2004, we and our consolidated subsidiaries had a total of 3,314 employees. Approximately 94% of our employees were employed outside of the United States.

Seasonality

Historically, our merchandising businesses have experienced holiday retail seasonality in their markets. In addition to seasonal fluctuations, our operating results fluctuate quarter-to-quarter as a result of economic and political events in markets served us, the timing of holidays, weather, the timing of shipments, product mix, and currency effects on the cost of U.S.-sourced products which may make these products more expensive in local currencies and less affordable. Because of such fluctuations, the results of operations of any quarter are not indicative of the results that may be achieved for a full fiscal year or any future quarter. In addition, there can be no assurance that our future results will be consistent with past results or the projections of securities analysts.

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Properties

Warehouse Club Properties. We, through our majority or wholly owned ventures or equity joint venture, own and/or lease properties in each country or territory in which we operate warehouse clubs. All buildings, both owned and leased, are constructed by independent contractors. The following is a summary of warehouse club locations currently owned and/or leased by country or territory:

Country / Territory	Date Opened or Anticipated	Date Closed	Ownership / Lease
Panama:			
Los Pueblos	October 25, 1996		Own land and building
Via Brazil	December 4, 1997		Lease land and building
El Dorado	November 11, 1999		Lease land and building
David	June 15, 2000		Own land and building
Guatemala:			
Mira Flores	April 8, 1999		Lease land and building
Guatemala City	August 24, 2000	August 15, 2003	Lease land and building
Pradera	May 29, 2001		Lease land and building
Costa Rica:			
Zapote	June 25, 1999		Own land and building
Escazu	May 12, 2000		Own land and building
Heredia	June 30, 2000		Own land and building
Moravia	Second half, calendar 2005		Will own land and building
Dominican Republic:			
Santo Domingo	December 10, 1999		Own land and building
Santiago	December 14, 1999		Own land and building
East Santo Domingo	October 12, 2000	June 15, 2003	Own land and building
El Salvador:			
Santa Elena	August 26, 1999		Own land and building
San Salvador	April 13, 2000		Own land and building
Honduras:			
San Pedro Sula	September 29, 1999		Own land and building
Tegucigalpa	May 31, 2000		Lease land and building
Aruba:			
Oranjestad	March 23, 2001		Lease land and building
Barbados:			
Bridgetown	August 31, 2001		Lease land and building
Philippines:			
Fort Bonifacio	May 18, 2001		Lease land(1)
Ortigas	November 8, 2001	August 3, 2003	Lease land(1)
Congressional	March 15, 2002		Lease land(1)
Alabang	November 16, 2002		Lease land(1)
Aseana	June 9, 2004		Lease land(1)
Trinidad:			
Chaguanas	August 4, 2000		Own land and building
Port of Spain	December 5, 2001		Lease land(1)
U.S. Virgin Islands:			
St. Thomas	May 4, 2001		Lease land(1)
Guam:			
Barrigada	March 8, 2002	December 24, 2003	Lease land and building
Jamaica:			
Kingston	March 28, 2003		Own land and building
Nicaragua:			
Managua	July 25, 2003		Own land and building

Mexico:		
Irapuato	November 14, 2002	Own land and building(2)
Celaya	November 16, 2002	Own land and building(2)
Queretaro	March 1, 2003	Own land and building(2)

(1) We constructed, at our expense, the building on land that we lease.

(2) Warehouse clubs are operated through a 50/50 joint venture which is accounted for under the equity method.

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Corporate Headquarters. We maintain our headquarters at 9740 Scranton Road, San Diego, California 92121-1745. We lease approximately 35,000 square feet of office space at a rate $47,115 per month, with a 2% annual increase. The current term expires on March 31, 2011. We lease a 32,387 square foot facility in Commerce, California at a rate of $16,546 per month that expires on May 31, 2005. The use of the Commerce, California facility was discontinued on August 31, 2004, resulting in a charge of $149,000 to the financial statements ended as of the same date. Additionally, we lease two facilities in Miami, Florida. The first is an 85,000 square foot facility leased at a rate of $43,370 per month that expires on June 30, 2005. The second is a 24,700 square foot facility leased at a rate of $29,601 per month that expires on February 28, 2006. We believe that our existing facilities are adequate to meet our current needs and that suitable additional or alternative space will be available on commercially reasonable terms as needed.

Environmental Matters. We agreed to indemnify Price Enterprises, Inc. for all of Price Enterprises liabilities (including obligations to indemnify Costco with respect to environmental liabilities) arising out of Price Enterprises prior ownership of properties we previously held for sale and the real properties transferred by Costco to Price Enterprises that Price Enterprises sold prior to the special dividend of our common stock by Price Enterprises on August 29, 1997. Our ownership of real properties and our agreement to indemnify Price Enterprises could subject us to certain environmental liabilities. As discussed below, certain properties are located in areas of current or former industrial activity, where environmental contamination may have occurred.

Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real estate may be required to investigate and remediate releases or threatened releases of hazardous or toxic substances or petroleum products located at such property, and may be held liable to a governmental entity or to third parties for property damage and for investigation and remediation costs incurred by such parties in connection with the contamination. Under certain of these laws, liability may be imposed without regard to whether the owner knew of or caused the presence of the contaminants. These costs may be substantial, and the presence of such substances, or the failure to remediate properly the contamination on such property, may adversely affect the owner s ability to sell or lease such property or to borrow money using such property as collateral. Certain federal and state laws require the removal or encapsulation of asbestos-containing material in poor condition in the event of remodeling or renovation. Other federal, state and local laws have been enacted to protect sensitive environmental resources, including threatened and endangered species and wetlands. Such laws may restrict the development and diminish the value of property that is inhabited by an endangered or threatened species, is designated as critical habitat for an endangered or threatened species or is characterized as wetlands.

In 1994, Costco engaged environmental consultants to conduct Phase I assessments (involving investigation without soil sampling or groundwater analysis) at each of the properties that Costco transferred to Price Enterprises in 1994, including the properties we previously held for sale. We are unaware of any environmental liability or noncompliance with applicable environmental laws or regulations arising out of the properties we previously held for sale or the real properties transferred by Costco to Price Enterprises and sold prior to the distribution that we believe would have a material adverse effect on our business, assets or results of operations. Nevertheless, there can be no assurance that our knowledge is complete with regard to, or that the Phase I assessments have identified, all material environmental liabilities.

We are aware of certain environmental issues, which we do not expect to have a material adverse effect on our business, financial condition, operating results, cash flow or liquidity, relating to three properties transferred from Costco to Price Enterprises that were sold prior to the distribution. We agreed to indemnify Price Enterprises for environmental liabilities arising out of such properties. Set forth below are summaries of certain environmental matters relating to these properties:

Meadowlands: The Meadowlands site is an unimproved, 12.9-acre site located in Meadowlands, New Jersey. A prior owner used this site as a debris disposal area. Elevated levels of heavy metals (including a small area contaminated with polychlorinated biphenyl) and petroleum hydrocarbons are present in soil at the Meadowlands site. To date, we have not been advised that Price Enterprises has been notified by any

governmental authority, and is not otherwise aware, of any material noncompliance, liability or claim relating to hazardous or toxic substances or petroleum products in connection with the Meadowlands site. Price Enterprises sold the Meadowlands site on August 11, 1995. Nevertheless, Price Enterprises previous ownership of the Meadowlands site creates the potential of liability for remediation costs associated with groundwater beneath the site.

Silver City: The Silver City site contains petroleum hydrocarbons in the soil and groundwater. There are no known receptors (groundwater users) down gradient of the Silver City site and the extent of soil and groundwater contamination is limited. On March 20, 1996, Price Enterprises sold the Silver City site and retained responsibility for certain environmental matters. We are continuing to remediate the soil and groundwater at this property under supervision of local authorities.

Legal Proceedings

From time to time, we and our subsidiaries are subject to legal proceedings and claims in the ordinary course of business, including those identified below. We evaluate such matters on a case by case basis, and vigorously contests any such legal proceedings or claims which we believe are without merit.

On November 17, 2003, following the announcement of the restatement of our financial results for fiscal year 2002 and the first three quarters of fiscal 2003 in November 2003, the first of six class action lawsuits were filed against us and certain of our former directors and officers purportedly brought on behalf of certain of our current and former holders of our common stock, and a seventh class action lawsuit was filed against us and certain of our former directors and officers purportedly on behalf of certain holders of our Series A Preferred Stock and a class of common stock purchasers. These suits, which were filed in United States District Court, Southern District of California, generally allege that we issued false and misleading statements during fiscal years 2002 and 2003 in violation of federal securities laws and seek relief including compensatory damages, costs and expenses, as well as recission by the holders of Series A Preferred Stock. All of the federal securities actions were consolidated under Master File No. 03CV2260 JAH (BLM) by an order dated September 9, 2004, which also appointed a lead plaintiff on behalf of the proposed class of common stock purchasers. The lead plaintiff filed a consolidated complaint on November 29, 2004, and the defendants will have until February 4, 2005 to move to dismiss or otherwise respond to the consolidated complaint.

On September 3, 2004, we entered into a Stipulation of Settlement only with respect to the action brought on behalf of a purported sub-class of plaintiffs comprised of unaffiliated purchasers of our Series A Preferred Stock. On November 8, 2004 the settlement was approved. Terms of the settlement include: (i) dismissal of the Series A Preferred lawsuit; (ii) the entry of an order releasing claims that were or could have been brought by the Series A subclass arising out of or relating to the purchase or ownership of the Series A Preferred Stock; (iii) the Series A Preferred subclass will be offered the opportunity to exchange their Series A Preferred Stock for shares of common stock valued at such purpose at a price of $10.00 per share; and (iv) the payment of plaintiffs attorneys fees and costs.

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

On September 3, 2004, we also entered into a Stipulation of Settlement for a stockholder derivative suit *Paulson v. Price, et al*. purportedly brought on our own behalf against our current and former directors and officers in Superior Court of the State of California, County of San Diego, Case No. GIC 822226, alleging among other things, breaches of fiduciary duty. The same complaint also alleges that various officers and directors violated California insider trading laws when they sold shares of our stock in 2002 because of their alleged knowledge of the accounting issues that caused the restatement. In the Stipulation of Settlement, the parties agreed that the prosecution and pendency of the litigation was a factor in our agreement to seek to implement the Financial Program that we announced on September 3, 2004. On November 12, 2004, the settlement was approved. Terms of the settlement include: (i) dismissal with prejudice of the derivative lawsuit; (ii) the entry of a judgment containing a release for the benefit of defendants; and (iii) payment of plaintiffs attorneys fees and costs.

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

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

In July 2003, our 34% minority interest shareholder in our Guatemalan operations (PriceSmart (Guatemala) S.A.) contended, among other things, that both we and the minority interest shareholder are entitled to receive a 15% annual return upon our respective capital investments in the Guatemalan operations. We have reviewed the claim and other pertinent information in relation to the Guatemalan joint venture agreement, as amended, and we do not concur with the minority shareholder s conclusion. The Guatemalan minority shareholder continues to assert a right to receive a 15% annual return on its capital investment, which it alleged had accrued to $1.7 million as of November 30, 2004. The Guatemalan minority shareholder additionally asserts that we have inappropriately charged PriceSmart (Guatemala), S.A. at least $11.4 million with regard to various fees, expenses and certain related matters. We have responded that we disagree with virtually all of the minority shareholder s assertions, and the minority shareholder advised that it might commission an audit with regard to such matters. On December 13, 2004, we initiated binding arbitration proceedings against the Guatemalan minority interest shareholder in an effort to obtain a declaration from the arbitrator that, among other things, the shareholders of PriceSmart (Guatemala), S.A. are not entitled to a 15% annual return on their investments and that PriceSmart (Guatemala), S.A. has not been inappropriately charged for various fees and expenses.

In addition, our two minority shareholders in the Philippines (which together comprise a 48% ownership interest in our Philippine operations (PSMT Philippines, Inc.)) have taken the position that an impasse of the Board of Directors of PSMT Philippines, Inc. has been reached. These minority shareholders have therefore sought to invoke the buy-sell provisions of the parties Shareholders Agreement (pursuant to which one shareholder may offer to purchase the interest of the other shareholders (at an appraised value) at which point the offeree shareholder may make a counter offer and the process continues until an offer is accepted). We contend, among other things, that pursuant to the terms of the Shareholders Agreement no impasse can be reached (and hence the buy-sell provisions do not become applicable) until after the respective shareholders principal representatives have met to discuss pending issues. Nevertheless, there is some likelihood that our dispute may result in litigation on this issue and on other matters pertaining to the Philippines operations.

The ultimate outcome of these disputes could have a material adverse effect on our business, financial condition, operating results, cash flow or liquidity. While we believe our interpretation of the relevant documents is correct, arbitration and litigation are inherently unpredictable. Further, regardless of the ultimate outcome of these suits, litigation of this type is expensive and may require that we devote substantial resources and management attention to these proceedings.

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MANAGEMENT

Executive Officers and Directors

The table below indicates the name, position with our company and age of each director and executive officer of our company as of November 30, 2004:

Name	Position	Age
Robert E. Price	Chairman of the Board; Interim Chief Executive Officer	62
James F. Cahill	Vice Chairman of the Board	49
Murray L. Galinson	Director	67
Katherine L. Hensley	Director	67
Leon C. Janks	Director	