Container Store Group, Inc.
Form 10-Q
January 10, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended November 30, 2013

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period From to

Commission File Number: 001-36161

THE CONTAINER STORE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**26-0565401** (I.R.S. Employer Identification No.)
500 Freeport Parkway Coppell, TX (Address of principal executive offices)	**75019** (Zip Code)

(972) 538-6000

(Registrant s telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes o No x

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o		Accelerated filer	o
Non-accelerated filer	x	(Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The registrant had 47,922,842 shares of its common stock outstanding as of December 31, 2013.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The Container Store Group, Inc.

Consolidated balance sheets (unaudited)

(In thousands)	November 30, 2013	March 2, 2013	November 24, 2012
Assets			
Current assets:			
Cash	$ 10,822	$ 25,351	$ 19,875
Accounts receivable, net	28,088	25,536	24,380
Inventory	105,124	82,443	96,106
Prepaid expenses and other current assets	24,297	21,284	20,359
Forward contracts		1,103	615
Deferred tax assets, net	1,505	1,505	1,203
Total current assets	169,836	157,222	162,538
Noncurrent assets:			
Property and equipment, net	150,142	141,177	136,901
Goodwill	202,815	202,815	202,815
Trade names	241,138	241,940	255,100
Deferred financing costs, net	10,188	8,745	9,114
Other assets	841	921	834
Total noncurrent assets	605,124	595,598	604,764
Total assets	$ 774,960	$ 752,820	$ 767,302

See accompanying notes.

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The Container Store Group, Inc.

Consolidated balance sheets (unaudited) (continued)

(In thousands, except share amounts)	November 30, 2013	March 2, 2013	November 24, 2012
Liabilities and shareholders equity			
Current liabilities:			
Accounts payable	$ 57,365	$ 54,334	$ 52,867
Accrued liabilities	57,211	52,330	53,429
Income taxes payable	496	2,650	1,398
Secured revolving credit, Sweden	16,679	13,482	17,027
Current portion of long-term debt	8,975	9,023	8,878
Total current liabilities	140,726	131,819	133,599
Noncurrent liabilities:			
Long-term debt	342,863	276,348	293,711
Deferred tax liabilities, net	89,837	87,770	88,366
Deferred rent and other long-term liabilities	24,252	23,508	22,227
Total noncurrent liabilities	456,952	387,626	404,304
Total liabilities	597,678	519,445	537,903
Commitments and contingencies *(Note 7)*			
Shareholders equity:			
Common stock, $0.01 par value, 250,000,000 shares authorized, 47,922,842 shares issued and outstanding at November 30, 2013; 3,528,280 shares authorized, 2,942,326 shares issued and 2,929,466 shares outstanding at March 2, 2013; 3,528,280 shares authorized, 2,942,326 shares issued and 2,928,490 shares outstanding at November 24, 2012	479	29	29
Preferred stock, $0.01 par value:			
Senior cumulative; no shares authorized, issued or outstanding at November 30, 2013; 250,000 shares authorized, 202,480 shares issued and 202,196 shares outstanding at March 2, 2013; 250,000 shares authorized, 202,480 shares issued and 202,200 shares outstanding at November 24, 2012		2	2
Junior cumulative no shares authorized, issued or outstanding at November 30, 2013; 250,000 shares authorized, 202,480 shares issued and 202,196 shares outstanding at March 2, 2013; 250,000 shares authorized, 202,480 shares issued and 202,200 shares outstanding at November 24, 2012		2	2
Additional paid-in capital	852,698	455,246	455,121
Accumulated other comprehensive income	716	2,713	965
Retained deficit	(676,611)	(223,830)	(225,924)
Treasury stock, no shares, 13,426, and 14,394 shares as of November 30, 2013, March 2, 2013, and November 24, 2012, respectively		(787)	(796)
Total shareholders equity	177,282	233,375	229,399
Total liabilities and shareholders equity	$ 774,960	$ 752,820	$ 767,302

See accompanying notes.

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The Container Store Group, Inc.

Consolidated statements of operations (unaudited)

(In thousands, except share and per share amounts)	Thirteen Weeks Ended November 30, 2013	Thirteen Weeks Ended November 24, 2012	Thirty-Nine Weeks Ended November 30, 2013	Thirty-Nine Weeks Ended November 24, 2012
Net sales	$ 188,298	$ 175,416	$ 531,716	$ 489,732
Cost of sales (excluding depreciation and amortization)	75,359	71,302	218,176	202,463
Gross profit	112,939	104,114	313,540	287,269
Selling, general, and administrative expenses (excluding depreciation and amortization)	88,797	81,715	257,870	237,022
Stock-based compensation	14,641	157	14,854	157
Pre-opening costs	1,827	2,137	5,761	6,573
Depreciation and amortization	7,569	7,336	22,620	21,825
Restructuring charges	111	2,056	472	4,365
Other expenses	869	335	1,495	817
(Gain) loss on disposal of assets	(4)	92	70	87
(Loss) income from operations	(871)	10,286	10,398	16,423
Interest expense, net	5,782	5,131	16,856	16,021
Loss on extinguishment of debt	128	4	1,229	7,333
(Loss) income before taxes	(6,781)	5,151	(7,687)	(6,931)
Provision (benefit) for income taxes	2,705	(1,711)	2,487	(4,708)
Net (loss) income	$ (9,486)	$ 6,862	$ (10,174)	$ (2,223)
Less: Distributions accumulated to preferred shareholders	(15,597)	(22,456)	(59,747)	(65,410)
Net loss available to common shareholders	$ (25,083)	$ (15,594)	$ (69,921)	$ (67,633)
Basic and diluted net loss per common share	$ (1.39)	$ (5.32)	$ (8.78)	$ (23.08)
Weighted-average common shares outstanding - basic and diluted	18,036,633	2,928,964	7,965,089	2,929,928

See accompanying notes.

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The Container Store Group, Inc.

Consolidated statements of comprehensive income (loss) (unaudited)

(In thousands)	Thirteen Weeks Ended November 30, 2013	Thirteen Weeks Ended November 24, 2012	Thirty-Nine Weeks Ended November 30, 2013	Thirty-Nine Weeks Ended November 24, 2012
Net (loss) income	$ (9,486)	$ 6,862	$ (10,174)	$ (2,223)
Unrealized gain (loss) on financial instruments, net of taxes of $(171), $(420), $(0), and $(427)	17	(511)	(1,104)	(116)
Pension liability adjustment	(16)	5	18	9
Foreign currency translation adjustment	1,283	(43)	(911)	(1,227)
Comprehensive (loss) income	$ (8,202)	$ 6,313	$ (12,171)	$ (3,557)

See accompanying notes.

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The Container Store Group, Inc.

Consolidated statements of shareholders equity (unaudited)

(In thousands, except share and per share amounts)	Par value	Common Stock Shares	Common Stock Amount	Senior Preferred Shares	Senior Preferred Amount	Junior Preferred Shares	Junior Preferred Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Treasury Stock Shares	Treasury Stock Amount	Total shareholders equity
Balance as of March 2, 2013	**$ 0.01**	**2,942,326**	**$ 29**	**202,480**	**$ 2**	**202,480**	**$ 2**	**$ 455,246**	**$ 2,713**	**$ (223,830)**	**(13,426)**	**$ (787)**	**$ 233,375**
Net loss										(10,174)			(10,174)
Payment of distributions to preferred shareholders										(295,813)			(295,813)
Exchange preferred shares for common shares		30,619,083	306	(202,182)	(2)	(202,182)	(2)	146,479		(146,781)			
Issuance of stock in initial public offering, net of costs		14,375,000	144					236,877					237,021
Tax effect of initial public offering costs								70					70
Additions of treasury stock											(737)	(53)	(53)
Retirement of treasury stock		(13,567)		(298)		(298)		(827)		(13)	14,163	840	
Fractional shares payout								(1)					(1)
Stock-based compensation								14,854					14,854
Foreign currency translation adjustment									(911)				(911)
Unrealized loss on financial instruments, net of taxes of $0									(1,104)				(1,104)
Pension liability adjustment, net of amortization									18				18
Balance as of November 30, 2013	**$ 0.01**	**47,922,842**	**$ 479**					**$ 852,698**	**$ 716**	**$ (676,611)**			**$ 177,282**

See accompanying notes

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The Container Store Group, Inc.

Consolidated statements of cash flows (unaudited)

(In thousands)	Thirty-Nine Weeks Ended November 30, 2013	November 24, 2012
Operating activities		
Net loss	$ (10,174)	$ (2,223)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	22,620	21,825
Stock-based compensation	14,854	157
Loss on disposal of property and equipment	70	87
Deferred tax expense (benefit)	1,540	(6,891)
Noncash interest	1,367	1,092
Noncash refinancing expense	851	4,843
Other noncash items	86	
Changes in operating assets and liabilities:		
Accounts receivable	(2,667)	(3,745)
Inventory	(22,748)	(24,936)
Prepaid expenses and other assets	(2,506)	(5,346)
Accounts payable and accrued liabilities	7,804	20,579
Income taxes payable	(1,531)	(70)
Other noncurrent liabilities	634	1,723
Net cash provided by operating activities	10,200	7,095
Investing activities		
Additions to property and equipment	(32,117)	(37,078)
Proceeds from sale of property and equipment	408	297
Net cash used in investing activities	(31,709)	(36,781)
Financing activities		
Borrowings on revolving lines of credit	50,098	62,527
Payments on revolving lines of credit	(46,694)	(56,555)
Borrowings on long-term debt	120,000	290,000
Payments on long-term debt	(53,580)	(287,437)
Payment of debt issuance costs	(3,662)	(9,842)
Proceeds from issuance of common stock, net	237,021	
Payment of distributions to preferred shareholders	(295,826)	
Purchase of treasury shares	(53)	(189)
Net cash provided by (used in) financing activities	7,304	(1,496)
Effect of exchange rate changes on cash	(324)	(106)
Net decrease in cash	(14,529)	(31,288)
Cash at beginning of period	25,351	51,163
Cash at end of period	$ 10,822	$ 19,875
Supplemental disclosures of non-cash activities:		
Exchange of outstanding preferred shares for common shares	$ 551,145	$

See accompanying notes.

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The Container Store Group, Inc.

Notes to consolidated financial statements (unaudited)

(In thousands, except share amounts and unless otherwise stated)

November 30, 2013

1. Nature of business and summary of significant policies

Nature of business

Description of business

The Container Store, Inc. was founded in 1978 in Dallas, Texas, as a retailer with a mission to provide customers with storage and organization solutions through an assortment of innovative products and unparalleled customer service. As of November 30, 2013, The Container Store, Inc. operates 63 stores with an average size of approximately 19,000 selling square feet in 22 states and the District of Columbia. The Container Store, Inc. also offers all of its products directly to its customers through its website and call center. The Container Store, Inc. s wholly owned Swedish subsidiary, Elfa International AB (Elfa) designs and manufactures component-based shelving and drawer systems that are customizable for any area of the home. elfa® branded products are sold exclusively in the United States in The Container Store® retail stores, website, and call center and Elfa sells to various retailers and distributors primarily in the Nordic region and throughout Europe on a wholesale basis. In 2007, The Container Store, Inc. was sold to The Container Store Group, Inc. (the Company and formerly known as TCS Holdings, Inc.), a holding company, of which a majority stake was purchased by Leonard Green and Partners, L.P. (LGP), with the remainder held by certain employees of The Container Store, Inc.

On October 31, 2013, the Company s board of directors approved a 5.9-for-one stock split of its existing common shares. All share and per share information has been retroactively adjusted to reflect the stock split.

On November 6, 2013, the Company completed its initial public offering (IPO). In connection with its IPO, the Company issued and sold 14,375,000 shares of its common stock at a price of $18.00 per share. Upon completion of the IPO, the Company received net proceeds of $237,021, after deducting the underwriting discount of $17,466 and offering expenses of $4,263. On November 6, 2013, net proceeds of $205,813 from the IPO were applied as follows: (i) a distribution was made to all 140 holders of the Company s 12% Senior Cumulative Preferred Stock (the Senior Preferred Stock) (including LGP and 130 of its current and former employees), which reduced the liquidation preference of such shares until such liquidation preference was reduced to $1,000.00 per share and (ii) a distribution was made to all 140 holders of the Company s 12% Junior Cumulative Preferred Stock (the Junior Preferred Stock) (including LGP and 130 of its current and former employees), which reduced the liquidation preference of such shares. On November 8, 2013, net proceeds from the IPO of $31,000 were used to repay a portion of the outstanding borrowings under the Senior Secured Term Loan Facility (as defined below). The remaining $208 of net proceeds from the IPO was used for other operating activities.

On November 6, 2013, the Company exchanged each outstanding share of its Senior Preferred Stock and Junior Preferred Stock for 30,619,083 shares of its common stock (the Exchange). You may refer to Note 9 of these financial statements for further information regarding the Exchange and other shareholders equity transactions during the period.

Seasonality

The Company s business is moderately seasonal in nature and, therefore, the results of operations for the thirty-nine weeks ended November 30, 2013 are not necessarily indicative of the operating results of the full year. Demand is generally the highest in the fourth fiscal quarter due to Our Annual elfa® Sale, and lowest in the first fiscal quarter.

Summary of significant policies

These unaudited interim consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and related notes as of and for the fiscal year ended March 2, 2013 included in the Company s final prospectus, dated October 31, 2013 and filed with the Securities and Exchange Commission (SEC) on November 1, 2013 (the October 31, 2013 Prospectus), constituting part of the Company s Registration Statement on Form S-1, as amended (Registration No. 333-191465), and filed with the SEC.

Basis of presentation

The accompanying unaudited condensed consolidated financial statements include The Container Store Group, Inc. and its wholly owned subsidiaries. All significant intercompany accounts, transactions, and balances have been eliminated in consolidation. The financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP) for interim financial information and applicable rules and regulations of the SEC regarding interim financial reporting. The consolidated balance sheets as of November 30, 2013 and November 24, 2012, the consolidated statements of operations and the consolidated statements of comprehensive income (loss) for the thirteen and thirty-nine weeks then ended, the consolidated statements of shareholders equity and the consolidated statements of cash flows for the thirty-nine weeks then ended have been prepared by the Company and are unaudited. In the opinion of management, the interim financial statements reflect all normal recurring adjustments necessary to present fairly the financial position at the balance sheet dates and the results of operations for the periods presented. The consolidated balance sheet as of March 2, 2013 has been derived from the audited consolidated balance sheet for the fiscal year then ended.

Fiscal Year

The Company follows a 5-4-4 fiscal calendar, whereby each fiscal quarter consists of thirteen weeks grouped into one five-week month and two four-week months, and its fiscal year ends on the Saturday closest to February 28th.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with Financial Accounting Standards Board Accounting Standards Codification (ASC) No. 718, Compensation-Stock Compensation, which requires the fair value of stock-based payments to be recognized in the consolidated financial statements as compensation expense over the requisite service period. Compensation expense based upon the fair value of awards is recognized on a straight line basis, net of forfeitures, over the requisite service period for awards that actually vest. Stock-based compensation expense is recorded in the stock-based compensation line in the consolidated statements of operations.

The Company estimates the fair value of each stock option grant on the date of grant based upon the Black-Scholes option-pricing model. This model requires various significant judgmental assumptions in order to derive a final fair value determination for each type of award including:

- Expected Term The expected term of the options represents the period of time between the grant date of the options and the date the options are either exercised or canceled, including an estimate of options still outstanding.

- Expected Volatility The expected volatility incorporates historical and implied volatility of comparable public companies for a period approximating the expected term.

- Expected Dividend Yield The expected dividend yield is based on the Company s expectation of not paying dividends on its common stock for the foreseeable future.

- Risk-Free Interest Rate The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant and with a maturity that approximates the expected term.

Foreign Currency Translation

The functional currency of the Company s foreign operations is the applicable country s currency. The functional currency for the Company s wholly owned subsidiary, Elfa, is the Swedish krona. All assets and liabilities of foreign subsidiaries and affiliates are translated at period-end rates of exchange. Revenues and expenses of foreign subsidiaries and affiliates are translated at weighted-average rates of exchange for the period. Realized gains and losses on purchases of inventory are included in cost of sales. All other realized gains and losses are included in selling, general, and administrative expenses in the consolidated statements of operations. Unrealized gains and losses are reported as cumulative translation adjustments through other comprehensive income (loss). The rates of exchange from Swedish krona to U.S. dollar were 6.5, 6.5, and 6.7 as of November 30, 2013, March 2, 2013, and November 24, 2012, respectively. The carrying amounts of net assets related to Elfa and subject to currency fluctuation were $151,950, $142,840, and $163,520 as of November 30, 2013, March 2, 2013, and November 24, 2012, respectively.

Management Estimates

The preparation of the Company s consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Reclassifications

Certain prior period amounts have been reclassified in order to provide consistent comparative information. These reclassifications do not materially impact the unaudited consolidated financial statements for the prior periods presented.

2. Long-term debt and revolving lines of credit

On April 6, 2012, The Container Store, Inc. s debt was refinanced. In connection with the refinancing, a new $275,000 Secured Term Loan Facility (the Senior Secured Term Loan Facility) was entered into. The Senior Secured Term Loan Facility replaced the previously existing $125,000 secured term loan and $150,000 of senior subordinated notes. In addition, a new $75,000 Revolving Credit Facility (the Revolving Credit Facility) was entered into replacing the previously existing $75,000 asset-based revolving credit facility (these transactions are referred to collectively as the Refinancing Transaction). The Company recorded expenses of $7,333 in fiscal 2012 associated with the Refinancing Transaction. This amount consisted of $1,655 related to an early extinguishment fee on the senior subordinated notes and $4,843 of deferred financing costs where accelerated amortization was required. The Company also recorded legal fees and other associated costs of $835.

On April 8, 2013, The Container Store, Inc. executed an amendment to the Senior Secured Term Loan Facility (the Increase and Repricing Transaction). Under the amendment, borrowings under the Senior Secured Term Loan Facility were increased to $362,250. Borrowings under the amended Senior Secured Term Loan Facility accrued interest at a new lower rate of LIBOR + 4.25%, subject to a LIBOR floor of 1.25% and the maturity date remained as April 6, 2019. Additionally, the amendment eliminated the senior secured leverage ratio requirement. The amendment did not eliminate the restrictions on the ability of the Company s subsidiaries to incur additional liens and indebtedness, make investments and dispositions, pay dividends or make other distributions, make loans, prepay certain indebtedness and enter into sale and lease back transactions. The Company recorded expenses of $1,101 during the thirty-nine weeks ended November 30, 2013 associated with the Increase and Repricing Transaction (all of which was incurred in the first quarter of 2013). The amount consisted of $723 of deferred financing costs where accelerated amortization was required. Legal fees and other associated costs of $378 were also recorded. You may refer to Note 9 in these interim financial statements for a discussion of the $90,000 distribution payment to senior preferred shareholders that was funded by the increased borrowings.

On November 8, 2013, net proceeds of $31,000 from the IPO were used to repay a portion of the outstanding borrowings under the Senior Secured Term Loan Facility.

On November 27, 2013, The Container Store, Inc. executed a second amendment to the Senior Secured Term Loan Facility (the Repricing Transaction). Under the amended Senior Secured Term Loan Facility, borrowings accrue interest at a new lower rate of LIBOR + 3.25%, subject to a LIBOR floor of 1.00% and the maturity date remained as April 6, 2019. The second amendment did not eliminate the restrictions on the ability of the Company s subsidiaries to incur additional liens and indebtedness, make investments and dispositions, pay dividends or make other distributions, make loans, prepay certain indebtedness and enter into sale and lease back transactions. The Company recorded expenses of $128, where accelerated amortization was required, during the thirteen weeks ended November 30, 2013 associated with the Repricing Transaction.

Long-term debt and revolving lines of credit consist of the following:

	November 30, 2013	March 2, 2013	November 24, 2012
Secured term loan, U.S.	$ 329,439	$ 272,938	$ 273,625
Secured term loan, Sweden	2,864	5,812	6,570
Secured revolving credit, U.S.	14,000		15,000
Mortgage and other loans	5,535	6,621	7,394
	351,838	285,371	302,589
Less current portion	(8,975)	(9,023)	(8,878)
	$ 342,863	$ 276,348	$ 293,711
Secured revolving credit, Sweden	$ 16,679	$ 13,482	$ 17,027

3. Inventory

The components of inventory are summarized below:

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	November 30, 2013	March 2, 2013	November 24, 2012
Raw materials	$ 5,011	$ 5,657	$ 6,404
Work-in-progress	1,618	1,983	1,948
Finished goods	98,495	74,803	87,754
	$ 105,124	$ 82,443	$ 96,106

4. Net income (loss) per share

Basic net income (loss) per common share is computed as net income (loss) available to common shareholders divided by the weighted average number of common shares outstanding for the period. Net income (loss) available to common shareholders is computed as net income (loss) less accumulated distributions to preferred shareholders for the period.

The following is a reconciliation of net income (loss) available to common shareholders and the number of shares used in the basic and diluted net loss per share calculations:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 30, 2013	November 24, 2012	November 30, 2013	November 24, 2012
Numerator:				
Net (loss) income	$ (9,486)	$ 6,862	$ (10,174)	$ (2,223)
Less: Distributions accumulated to preferred shareholders	(15,597)	(22,456)	(59,747)	(65,410)
Net loss available to common shareholders	$ (25,083)	$ (15,594)	$ (69,921)	$ (67,633)
Denominator:				
Weighted average common shares outstanding basic and diluted	18,036,633	2,928,964	7,965,089	2,929,928
Basic and diluted net loss per common share	$ (1.39)	$ (5.32)	$ (8.78)	$ (23.08)
Antidilutive securities not included:				
Stock options outstanding	319,190		140,527	

5. Pension plan

The Company provides pension benefits to the employees of Elfa under collectively bargained pension plans in Sweden, which are recorded in other long-term liabilities. The defined benefit plan provides benefits for participating employees based on years of service and final salary levels at retirement. The defined benefit plans are unfunded and approximately 2% of Elfa employees are participants in the defined benefit pension plan. Certain employees also participate in defined contribution plans for which Company contributions are determined as a percentage of participant compensation. The Company contributed $2,117 and $2,281 for defined contribution plans in the thirty-nine weeks ended November 30, 2013 and November 24, 2012, respectively.

6. Income taxes

The Company s effective income tax rate for the thirty-nine weeks ended November 30, 2013 was (32.4%) compared to 67.9% for the thirty-nine weeks ended November 24, 2012. The effective income tax rates fell below the federal statutory rate in 2013 primarily due to $5,707 of tax expense resulting from a valuation allowance recorded on the IPO-related stock-based compensation deferred tax asset recorded in the third quarter and $719 of tax expense resulting from a valuation allowance recorded on deferred tax assets of certain foreign subsidiaries of the Company. The effective income tax rates exceeded the federal statutory rate in 2012 primarily due to decreases in the valuation allowance on deferred tax assets and a $3,742 tax benefit recorded in 2012 related a reduction in statutory Swedish tax rates and special economic zone incentives in Poland.

7. Commitments and contingencies

In connection with insurance policies, The Container Store, Inc. has outstanding standby letters of credit totaling $2,986 as of November 30, 2013.

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The Company is subject to various legal proceedings and claims, including employment claims, wage and hour claims, intellectual property claims, contractual and commercial disputes and other matters that arise in the ordinary course of business. While the outcome of these and other claims cannot be predicted with certainty, management does not believe that the outcome of these matters will have a material adverse effect on the Company s business, results of operations, or financial condition on an individual basis or in the aggregate.

8. Stock-based compensation

In fiscal 2012, the Company implemented the 2012 Stock Option Plan of The Container Store Group, Inc. (2012 Equity Plan). The 2012 Equity Plan provides for grants of nonqualified stock options and incentive stock options. On October 31, 2013, the Company s board of directors approved the modification of 240,435 outstanding stock options granted under the 2012 Equity Plan to provide for immediate vesting. The Company recognized approximately $1,594 of compensation expense in the thirteen weeks ended November 30, 2013 related to the modification of these stock options.

On October 16, 2013, the Company s board of directors approved the 2013 Incentive Award Plan (2013 Equity Plan). The 2013 Equity Plan provides for grants of nonqualified stock options, incentive stock options, restricted stock, restricted stock units, deferred stock awards, deferred stock units, stock appreciation rights, dividends equivalents, performance awards, and stock payments. There were 3,616,570 shares reserved for issuance under the 2013 Equity Plan.

On October 31, 2013, the Company granted 2,622,721 nonqualified stock options under the 2013 Equity Plan to its directors and certain of its employees. The stock options granted were approved by the Company s board of directors and consisted of nonqualified stock options as defined by the IRS for corporate and individual tax reporting purposes. There were 1,666,066 options granted that immediately vested upon closing of the IPO on November 6, 2013. The remaining stock options granted will vest in equal annual installments over 7 years. The Company recognized $13,008 of compensation expense in the thirteen weeks ended November 30, 2013 related to the 2013 Equity Plan options granted.

Stock-based compensation cost is measured at the grant date fair value and is recognized as an expense in the consolidated statements of operations, on a straight-line basis over the employee s requisite service period (generally the vesting period of the equity grant). The Company estimates forfeitures for option grants that are not expected to vest. Stock-based compensation cost recognized in the thirteen and thirty-nine weeks ended November 30, 2013 totaled $14,641 and $14,854, respectively. Stock-based compensation cost recognized in the thirteen and thirty-nine weeks ended November 24, 2012 totaled $157. As of November 30, 2013, there was a remaining unrecognized compensation cost of $7,916 (net of estimated forfeitures) that the Company expects to be recognized on a straight-line basis over an average remaining service period of approximately 6.9 years.

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The following table summarizes the Company s stock option activity during the thirty-nine weeks ended November 30, 2013:

	Shares	Weighted-average exercise price (Per share data)	Weighted-average contractual term remaining (In Years)
Balance at March 2, 2013:	244,064	$ 17.01	
Granted	2,622,721	$ 18.00	
Exercised			
Canceled	(7,627)	$ 17.49	
Balance at November 30, 2013	2,859,158	$ 17.92	9.81

The aggregate intrinsic value of the 2,859,158 stock options outstanding is $65,112. The Company has 1,906,017 exercisable stock options as of November 30, 2013 with a weighted average exercise price of $17.88 and an aggregate intrinsic value of $43,485.

The fair value of stock options is estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

- Expected Term The expected term of the options represents the period of time between the grant date of the options and the date the options are either exercised or canceled, including an estimate of options still outstanding. The Company utilized the simplified method for calculating the expected term for stock options as we do not have sufficient historical data to calculate based on actual exercise and forfeiture activity.

- Expected Volatility The expected volatility incorporates historical and implied volatility of comparable public companies for a period approximating the expected term.

- Expected Dividend Yield The expected dividend yield is based on the Company s expectation of not paying dividends on its common stock for the foreseeable future.

- Risk-Free Interest Rate The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant and with a maturity that approximates the expected term.

The following table summarizes the weighted-average assumptions used to measure the grant date fair value of the non-qualified stock options granted under the 2013 Equity Plan using the Black Scholes option pricing model for the thirty-nine weeks ended November 30, 2013:

	Thirty-Nine Weeks Ended November 30, 2013
Expected term	5.7 years
Expected volatility	48.28%
Risk-free interest rate	1.49%
Expected dividend yield	0%

9. Shareholders equity

Common stock

On August 16, 2007, the Company issued 2,942,326 shares of common stock (giving effect to the stock split discussed below) with a par value of $0.01 per share at a price of $17.01 per share. The holders of common stock are entitled to one vote per common share. The holders have no preemptive or other subscription rights and there are no redemptions or sinking fund provisions with respect to such shares. Common stock is subordinate to any preferred stock outstanding with respect to rights upon liquidation and dissolution of the Company.

On October 31, 2013, the Company s board of directors retired 13,567 shares of common stock (giving effect to the stock split discussed below) held in treasury.

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On October 31, 2013, the Company s board of directors approved a 5.9-for-one stock split of its existing common shares. All share and per share information has been retroactively adjusted to reflect the stock split.

On November 6, 2013, the Company completed its IPO. In connection with its IPO, the Company issued and sold 14,375,000 shares of its common stock at a price of $18.00 per share. Upon completion of the offering, the Company received net proceeds of approximately $237,021, after deducting the underwriting discount of $17,466 and offering expenses of $4,263.

Preferred Stock

On April 9, 2013, the Company paid a distribution to holders of its Senior Preferred Stock in the amount of $90,000. Refer to Note 2 for a discussion of the Increase and Repricing Transaction whereby $90,000 of additional secured term loans were executed to fund this distribution. There were zero, $382,847, and $357,908 cumulative preferred share distributions in arrears as of November 30, 2013, March 2, 2013 and November 24, 2012, respectively. These distributions in arrears were not declared by the board of directors and, therefore, have not been accrued on the accompanying consolidated balance sheets as of March 2, 2013 and November 24, 2012. The distributions in arrears were eliminated as of November 6, 2013 through the Distribution and the Exchange, discussed below.

On October 31, 2013, the Company s board of directors retired 298 shares of Senior Preferred Stock and 298 shares of Junior Preferred Stock held in treasury.

On November 6, 2013, in connection with the completion of the Company s IPO, a distribution in the aggregate amount of $205,813 (the Distribution), was paid from the net proceeds of the offering, (i) first, to all 140 holders of the Company s Senior Preferred Stock (including LGP and 130 current and former employees of the Company), which reduced the liquidation preference of such shares until such liquidation preference was reduced to $1,000.00 per share and (ii) second, the remainder was distributed to all 140 holders of the Company s Junior Preferred Stock (including LGP and 130 current and former employees of the Company), which reduced the liquidation preference of such shares.

On November 6, 2013, the Company consummated the Exchange, pursuant to which the Company exchanged the liquidation preference per outstanding share of its Senior Preferred Stock and Junior Preferred Stock, after giving effect to the payment of the Distribution, for 30,619,083 shares of its common stock. The amount of common stock issued in the Exchange was determined by dividing (a) the liquidation preference amount of such preferred stock by (b) the IPO price of $18.00 per share. On an as adjusted basis to give effect to the Distribution and prior to the Exchange, the liquidation preference per share of its outstanding Senior Preferred Stock was $1,000.00 and the liquidation preference per share of its outstanding Junior Preferred Stock was $1,725.98.

Following the Exchange, the Company has no outstanding preferred stock.

10. Accumulated other comprehensive income (loss) (AOCI)

A rollforward of the amounts included in AOCI, net of taxes, is shown below for the thirty-nine weeks ended November 30, 2013:

	Foreign currency forward contracts	Minimum pension liability	Foreign currency translation	Total
Balance at March 2, 2013	$ 1,545	$ (972)	$ 2,140	$ 2,713
Other comprehensive income (loss) before reclassifications, net of tax	(560)	18	(911)	(1,453)
Amounts reclassified to earnings, net of tax	(544)			(544)
Balance at November 30, 2013	$ 441	$ (954)	$ 1,229	$ 716

Amounts reclassified from accumulated other comprehensive income (loss) for the foreign currency forward contracts category are generally included in cost of sales in the Company s consolidated statements of operations. For a description of the Company s use of foreign currency forward contracts, refer to Note 11.

11. Foreign currency forward contracts

The Company s international operations and purchases of its significant product lines from foreign suppliers are subject to certain opportunities and risks, including foreign currency fluctuations. The Company utilizes foreign currency forward exchange contracts in Swedish krona to stabilize its retail gross margins and to protect its domestic operations from downward currency exposure by hedging purchases of inventory from its wholly owned subsidiary, Elfa. In the thirty-nine weeks ended November 30, 2013, the Company used forward contracts for 87% of inventory purchases in

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Swedish krona. All of the Company s currency-related hedge instruments have terms from 1 to 12 months and require the Company to exchange currencies at agreed-upon rates at settlement. The counterparties to the contracts consist of a limited number of major domestic and international financial institutions. The Company does not hold or enter into financial instruments for trading or speculative purposes. The Company records its financial hedge instruments on a gross basis and generally does not require collateral from these counterparties because it does not expect any losses from credit exposure. The Company does not have any material financial hedge instruments that do not qualify for hedge accounting treatment as of November 30, 2013, March 2, 2013 and November 24, 2012. The Company records all foreign currency forward contracts on its consolidated balance sheets at fair value. Forward contracts not designated as hedges are adjusted to fair value through income.

The Company accounts for its foreign currency hedge instruments as cash flow hedges, as defined. Changes in the fair value of the foreign currency hedge instruments that are considered to be effective, as defined, are recorded in accumulated other comprehensive income (loss) until the hedged item (inventory) is sold to the customer, at which time the deferred gain or loss is recognized through cost of sales. Any portion of a change in the foreign currency hedge instruments fair value that is considered to be ineffective, as defined, or that the Company has elected to exclude from its measurement of effectiveness, is immediately recorded in earnings as cost of sales. The Company recorded the fair value of its unsettled foreign currency forward contracts as cash flow hedges, resulting in zero, $1,103, and $615 total current asset in the consolidated balance sheet as of November 30, 2013, March 2, 2013, and November 24, 2012, respectively.

The Company recorded $441 in accumulated other comprehensive gain at November 30, 2013, all of which represents unrealized gains that have been recorded for settled forward contracts related to inventory on hand as of November 30, 2013. The Company expects the unrealized gain of $441, net of taxes, to be reclassified into earnings over the next 12 months as the underlying inventory is sold to the end customer.

12. Fair value measurements

Under generally accepted accounting principles, the Company is required to a) measure certain assets and liabilities at fair value or b) disclose the fair values of certain assets and liabilities recorded at cost. Accounting standards define fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date. Fair value is calculated assuming the transaction occurs in the principal or most advantageous market for the asset or liability and includes consideration of non-performance risk and credit risk of both parties. Accounting standards pertaining to fair value establish a three- tier fair value hierarchy that prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1 valuation inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.

- Level 2 valuation inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- Level 3 valuation inputs are unobservable and typically reflect management s estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are determined using model-based techniques that include option pricing models, discounted cash flow models and similar techniques.

As of November 30, 2013, March 2, 2013, and November 24, 2012, the Company held certain items that are required to be measured at fair value on a recurring basis. These included cash, the nonqualified retirement plan, and foreign currency forward contracts. Cash consists of cash on hand. The nonqualified retirement plan consists of investments purchased by employee contributions to retirement savings accounts. Foreign currency forward contracts are related to the Company s efforts to manage foreign currency fluctuation on purchases of inventory in Swedish krona. The Company s foreign currency hedge instruments consist of over-the-counter (OTC) contracts, which are not traded on a public exchange. See Note 11 for further information on the Company s hedging activities.

The fair values of the nonqualified retirement plan and foreign currency forward contracts are determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Company has categorized these items as Level 2. The Company has consistently applied these valuation techniques in all periods presented and believes it has obtained the most accurate information available for the types of contracts it holds.

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The following items are measured at fair value on a recurring basis, subject to the disclosure requirements of ASC 820 at November 30, 2013, March 2, 2013, and November 24, 2012:

Description		**Balance Sheet Location**	**November 30, 2013**	**March 2, 2013**	**November 24, 2012**
Assets					
Cash	Level 1	Cash	$ 10,822	$ 25,351	$ 19,875
Nonqualified retirement plan	Level 2	Prepaid expenses and other current assets	3,200	2,569	2,326
Foreign currency hedge instruments	Level 2	Forward contracts		1,103	615
Total assets			$ 14,022	$ 29,023	$ 22,816
Liabilities					
Nonqualified retirement plan	Level 2	Accrued liabilities	3,207	2,582	2,338
Total liabilities			$ 3,207	$ 2,582	$ 2,338

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The fair values of long-term debt were estimated using discounted cash flow analyses, based on the Company s current incremental borrowing rates for similar types of borrowing arrangements (Level 3 valuations). As of November 30, 2013, March 2, 2013, and November 24, 2012, the carrying values and estimated fair values of the Company s long-term debt, including current maturities, were:

	November 30, 2013	
	Carrying value	Fair value
Secured term loan, U.S.	$ 329,439	$ 329,439
Secured term loan, Sweden	2,864	2,959
Secured revolving credit, U.S.	14,000	14,000
Other loans	5,535	5,521
Total	$ 351,838	$ 351,919