VISTEON CORP
Form 10-Q
August 08, 2007

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended June 30, 2007, 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 1-15827**

**VISTEON CORPORATION**
*(Exact name of Registrant as specified in its charter)*

| **Delaware**<br>(State of incorporation) | **38-3519512**<br>(I.R.S. employer Identification number) |
|---|---|
| **One Village Center Drive, Van Buren Township, Michigan**<br>(Address of principal executive offices) | **48111**<br>(Zip code) |

Registrant s telephone number, including area code: (800)-VISTEON

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 ü No___

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

Large Accelerated Filer ü Accelerated Filer ___ Non-Accelerated Filer ___

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes____ No_ü_

As of August 3, 2007, the Registrant had outstanding 129,713,659 shares of common stock, par value $1.00 per share.

**Exhibit index located on page number 53.**

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**VISTEON CORPORATION AND SUBSIDIARIES**
**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007**

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# PART I
# FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (unaudited)

### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Visteon Corporation

We have reviewed the accompanying consolidated balance sheet of Visteon Corporation and its subsidiaries as of June 30, 2007 and the related consolidated statements of operations for each of the three-month and six-month periods ended June 30, 2007 and June 30, 2006 and the consolidated statements of cash flows for the six-month periods ended June 30, 2007 and June 30, 2006. These interim financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2006, and the related consolidated statements of operations, shareholders (deficit) / equity and cash flows for the year then ended (not presented herein), and in our report dated February 28, 2007, except for Note 20, as to which the date is August 3, 2007, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet information as of December 31, 2006 is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

**PricewaterhouseCoopers LLP**

Detroit, Michigan
August 8, 2007

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**VISTEON CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
**(Unaudited)**

| | Three-Months Ended June 30 | | Six-Months Ended June 30 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions, Except Per Share Data) | | | |
| Net sales | | | | |
| Products | $ 2,833 | $ 2,819 | $ 5,591 | $ 5,585 |
| Services | 141 | 138 | 271 | 283 |
| | 2,974 | 2,957 | 5,862 | 5,868 |
| Cost of sales | | | | |
| Products | 2,679 | 2,507 | 5,322 | 5,026 |
| Services | 140 | 137 | 268 | 281 |
| | 2,819 | 2,644 | 5,590 | 5,307 |
| **Gross margin** | 155 | 313 | 272 | 561 |
| Selling, general and administrative expenses | 145 | 194 | 314 | 361 |
| Asset impairments | 11 | 22 | 51 | 22 |
| Restructuring expenses | 37 | 12 | 62 | 21 |
| Reimbursement from Escrow Account | 47 | 12 | 82 | 21 |
| **Operating income (loss)** | 9 | 97 | (73) | 178 |
| Interest expense | 55 | 53 | 104 | 100 |
| Interest income | 14 | 7 | 23 | 15 |
| Debt extinguishment gain | | 8 | | 8 |
| Equity in net income of non-consolidated affiliates | 14 | 12 | 23 | 19 |
| **(Loss) income before income taxes, minority interests, discontinued operations, change in accounting and extraordinary item** | (18) | 71 | (131) | 120 |
| Provision for income taxes | 28 | 17 | 45 | 47 |
| Minority interests in consolidated subsidiaries | 14 | 10 | 20 | 17 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Net (loss) income from continuing operations before change in accounting and extraordinary item** | | (60) | | 44 | | (196) | | 56 |
| Loss from discontinued operations, net of tax | | 7 | | 2 | | 24 | | 7 |
| **Net (loss) income before change in accounting and extraordinary item** | | (67) | | 42 | | (220) | | 49 |
| Cumulative effect of change in accounting, net of tax | | | | | | | | (4) |
| **Net (loss) income before extraordinary item** | | (67) | | 42 | | (220) | | 45 |
| Extraordinary item, net of tax | | | | 8 | | | | 8 |
| **Net (loss) income** | $ | (67) | $ | 50 | $ | (220) | $ | 53 |
| **Basic and diluted (loss) earnings per share:** | | | | | | | | |
| Continuing operations | $ | (0.46) | $ | 0.34 | $ | (1.52) | $ | 0.44 |
| Discontinued operations | $ | (0.06) | $ | (0.01) | $ | (0.18) | $ | (0.06) |
| Net (loss) earnings | $ | (0.52) | $ | 0.39 | $ | (1.70) | $ | 0.41 |

See accompanying notes to the consolidated financial statements.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**

| | (Unaudited) June 30 2007 | December 31 2006 |
|---|---|---|
| | (Dollars in Millions) | |
| **ASSETS** | | |
| Cash and equivalents | $ 1,473 | $ 1,057 |
| Accounts receivable, net | 1,347 | 1,245 |
| Interests in accounts receivable transferred | 551 | 482 |
| Inventories, net | 523 | 520 |
| Other current assets | 284 | 261 |
| **Total current assets** | 4,178 | 3,565 |
| Equity in net assets of non-consolidated affiliates | 215 | 224 |
| Property and equipment, net | 2,790 | 3,034 |
| Other non-current assets | 143 | 115 |
| **Total assets** | $ 7,326 | $ 6,938 |
| **LIABILITIES AND SHAREHOLDERS DEFICIT** | | |
| Short-term debt, including current portion of long-term debt | $ 100 | $ 100 |
| Accounts payable | 1,876 | 1,825 |
| Accrued employee liabilities | 305 | 323 |
| Other current liabilities | 376 | 320 |
| **Total current liabilities** | 2,657 | 2,568 |
| Long-term debt | 2,605 | 2,128 |
| Employee benefits, including pensions | 674 | 924 |
| Postretirement benefits other than pensions | 637 | 747 |
| Deferred income taxes | 218 | 170 |
| Other non-current liabilities | 363 | 318 |
| Minority interests in consolidated subsidiaries | 274 | 271 |
| Shareholders deficit | | |
| Preferred stock (par value $1.00, 50 million shares authorized, none outstanding) | | |
| Common stock (par value $1.00, 500 million shares authorized, 131 million shares issued, 130 million and 129 million shares outstanding, respectively) | 131 | 131 |
| Stock warrants | 127 | 127 |
| Additional paid-in capital | 3,403 | 3,398 |

| | | |
|---|---|---|
| Accumulated deficit | (3,863) | (3,606) |
| Accumulated other comprehensive income (loss) | 113 | (216) |
| Other | (13) | (22) |
| **Total shareholders deficit** | (102) | (188) |
| **Total liabilities and shareholders deficit** | $ 7,326 | $ 6,938 |

See accompanying notes to the consolidated financial statements.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(Unaudited)**

| | Six -Months Ended June 30 | |
|---|---|---|
| | 2007 | 2006 |
| | (Dollars in Millions) | |
| **Operating Activities** | | |
| Net (loss) income | $ (220) | $ 53 |
| Adjustments to reconcile net (loss) income to net cash provided from operating activities: | | |
| Depreciation and amortization | 237 | 208 |
| Asset impairments | 63 | 22 |
| Non-cash postretirement benefits | 27 | (72) |
| Non-cash tax items | (30) | (5) |
| Equity in net income of non-consolidated affiliates, net of dividends remitted | 15 | 3 |
| Extraordinary item, net of tax | | (8) |
| Debt extinguishment gain | | (8) |
| Other non-cash items | 5 | (4) |
| Change in receivables sold | (65) | (55) |
| Changes in assets and liabilities: | | |
| Accounts receivable and retained interests | (82) | 20 |
| Escrow receivable | 13 | 24 |
| Inventories | (22) | (19) |
| Accounts payable | 50 | (173) |
| Postretirement benefits other than pensions | 4 | 10 |
| Income taxes deferred and payable, net | 8 | 18 |
| Other assets and liabilities | 12 | 62 |
| Net cash provided from operating activities | 15 | 76 |
| **Investing Activities** | | |
| Capital expenditures | (144) | (183) |
| Proceeds from divestiture and asset sales | 90 | 11 |
| Other investments | (1) | |
| Net cash used by investing activities | (55) | (172) |
| **Financing Activities** | | |
| Short-term debt, net | (4) | (373) |
| Proceeds from debt, net of issuance costs | 497 | 1,176 |
| Principal payments on debt | (18) | (610) |
| Repurchase of unsecured debt securities | | (141) |
| Other, including book overdrafts | (31) | (9) |

| | | |
|---|---|---|
| Net cash provided from financing activities | 444 | 43 |
| Effect of exchange rate changes on cash | 12 | 24 |
| Net increase (decrease) in cash and equivalents | 416 | (29) |
| **Cash and equivalents at beginning of year** | 1,057 | 865 |
| **Cash and equivalents at end of period** | $ 1,473 | $ 836 |

See accompanying notes to the consolidated financial statements.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(Unaudited)**

**NOTE 1. Description of Business and Company Background**

Visteon Corporation (the Company or Visteon ) is a leading global supplier of automotive systems, modules and components. The Company sells products primarily to global vehicle manufacturers and also sells to the worldwide aftermarket for replacement and enhancement parts. Headquartered in Van Buren Township, Michigan, with regional headquarters in Kerpen, Germany and Shanghai, China, the Company has a workforce of approximately 43,000 employees and a network of manufacturing operations, technical centers, sales offices and joint ventures in every major geographic region of the world.

The Company maintains significant commercial relationships with Ford Motor Company ( Ford ) and its affiliates. Accordingly, transactions with Ford constitute a significant amount of the Company s product sales and service revenues, accounts receivable and certain postretirement benefit obligations as summarized below (including amounts from discontinued operations):

| | Three-Months Ended June 30 | | Six-Months Ended June 30 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | |
| Net sales | | | | |
| Products | $ 1,122 | $ 1,371 | $ 2,304 | $ 2,710 |
| Services | $ 138 | $ 138 | $ 268 | $ 283 |

| | June 30 2007 | December 31 2006 |
|---|---|---|
| | (Dollars in Millions) | |
| Accounts receivable, net | $ 355 | $ 348 |
| Postretirement employee benefits | $ 124 | $ 127 |

Additionally, as of June 30, 2007 and December 31, 2006, the Company transferred approximately $220 million and $200 million, respectively, of Ford receivables under a European receivables securitization agreement.

**NOTE 2. Basis of Presentation**

The unaudited consolidated financial statements of the Company have been prepared in accordance with the rules and regulations of the U.S. Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) have been condensed or omitted pursuant to such rules and regulations.

These interim consolidated financial statements include adjustments (consisting of normal recurring adjustments) that management believes are necessary for a fair presentation of the results of operations, financial position and cash flows of the Company for the interim periods presented. The Company s management believes that the disclosures are

adequate to make the information presented not misleading when read in conjunction with the consolidated financial statements for the fiscal year ended December 31, 2006 and the notes thereto included in the Company s Current Report on Form 8-K , as filed with the SEC on August 3, 2007. Interim results are not necessarily indicative of full year results.



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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2. Basis of Presentation (Continued)**

*Principles of Consolidation:* The consolidated financial statements include the accounts of the Company and all subsidiaries that are more than 50% owned and over which the Company exercises control. Investments in affiliates of 50% or less but greater than 20% are accounted for using the equity method. The consolidated financial statements also include the accounts of certain entities in which the Company holds a controlling interest based on exposure to economic risks and potential rewards (variable interests) for which it is the primary beneficiary.

*Revenue Recognition:* The Company records revenue when persuasive evidence of an arrangement exists, delivery occurs or services are rendered, the sales price or fee is fixed or determinable and collectibility is reasonably assured. The Company ships product and records revenue pursuant to commercial agreements with its customers generally in the form of an approved purchase order, including the effects of contractual customer price productivity. The Company does negotiate discrete price changes with its customers, which are generally the result of unique commercial issues between the Company and its customers and are generally the subject of specific negotiations between the Company and its customers. The Company records amounts associated with discrete price changes as a reduction to revenue when specific facts and circumstances indicate that a price reduction is probable and the amounts are reasonably estimable. The Company records amounts associated with discrete price changes as an increase to revenue upon execution of a legally enforceable contractual agreement and when collectibility is reasonably assured.

Revenue from services is recognized as services are rendered. Costs associated with providing such services are recorded as incurred.

*Reclassifications:* Certain prior period amounts have been reclassified to conform to current period presentation.

*Use of Estimates:* The preparation of financial statements in conformity with GAAP requires management to make estimates, judgments and assumptions that affect amounts reported herein. Management believes that such estimates, judgments and assumptions are reasonable and appropriate. However, due to the inherent uncertainty involved, actual results may differ from those provided in the Company s consolidated financial statements.

*Assets and Liabilities Held for Sale:* In accordance with Statement of Financial Accounting Standards No. 144, ( SFAS 144 ) Accounting for the Impairment or Disposal of Long-Lived Assets, the Company classifies assets and liabilities as held for sale when management approves and commits to a formal plan of sale and it is probable that the sale will be completed. The carrying value of the assets and liabilities held for sale are recorded at the lower of carrying value or fair value less cost to sell, and the recording of depreciation is ceased.

*Recent Accounting Pronouncements:* In February 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 159 ( SFAS 159 ), The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. SFAS 159 permits measurement of financial instruments and certain other items at fair value. SFAS 159 is designed to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective as of the beginning of the first fiscal year after November 15, 2007. The Company is currently evaluating the impact of this statement on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 Fair Value Measurements. This statement, which becomes effective January 1, 2008, defines fair value, establishes a framework

for measuring fair value and expands disclosure requirements regarding fair value measurements. The Company is currently evaluating the impact of this statement on its consolidated financial statements.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2. Basis of Presentation (Continued)**

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156 ( SFAS 156 ), Accounting for Servicing of Financial Assets. This statement amends Statement of Financial Accounting Standards No. 140, ( SFAS 140 ), Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Company adopted SFAS 156 as of January 1, 2007 without a material impact on its consolidated financial statements.

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155 ( SFAS 155 ), Accounting for Certain Hybrid Financial Instruments which amends Statement of Financial Accounting Standards No. 133 ( SFAS 133 ), Accounting for Derivatives Instruments and Hedging Activities and SFAS 140. SFAS 155 amends SFAS 133 to narrow the scope exception for interest-only and principal only strips on debt instruments to include only such strips representing rights to receive a specified portion of the contractual interest or principal cash flows. The Company adopted SFAS 155 as of January 1, 2007 without a material impact on its consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in accordance with Statement of Financial Accounting Standards No. 109 ( SFAS 109 ) Accounting for Income Taxes and prescribes a recognition threshold and measurement process for recording in financial statements tax positions taken or expected to be taken in a tax return. The evaluation of a tax position under FIN 48 is a two-step process. The first step requires an entity to determine whether it is more likely than not that a tax position will be sustained upon examination based on the technical merits of the position. For those positions that meet the more likely than not recognition threshold, the second step requires measurement of the largest amount of benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. The Company adopted the provisions of FIN 48 effective January 1, 2007, without a material impact to the Company s consolidated financial statements.

**NOTE 3. Discontinued Operations**

In March 2007, the Company entered into a Master Asset and Share Purchase Agreement ( MASPA ) to sell certain assets and liabilities associated with the Company s chassis operations (the Chassis Divestiture ). The Company s chassis operations are primarily comprised of suspension, driveline and steering product lines and include facilities located in Dueren and Wuelfrath, Germany, Praszka, Poland and Sao Paulo, Brazil. Collectively, these operations recorded sales for the year ended December 31, 2006 of approximately $600 million. The Chassis Divestiture, while representing a significant portion of the Company s chassis operations, did not result in the complete exit of any of the affected product lines.

Effective May 31, 2007, the Company ceased to produce brake components at its Swansea, Wales, U.K. facility, which resulted in the complete exit of the Company s global suspension product line. Accordingly, the results of operations of the Company s global suspension product line have been reclassified to Loss from discontinued operations, net of tax on the consolidated statements of operations for the three and six-month periods ended June 30, 2007 and 2006.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 3. Discontinued Operations (Continued)**

A summary of the results of operations for the global suspension systems product line for the three and six-month periods ended June 30, 2007 and 2006 is provided in the table below.

| | Three-Months Ended June 30 | | Six-Months Ended June 30 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | |
| Net product sales | $ 11 | $ 45 | $ 50 | $ 94 |
| Cost of sales | 18 | 46 | 63 | 100 |
| Gross margin | (7) | (1) | (13) | (6) |
| Selling, general and administrative expenses | | 1 | 1 | 1 |
| Asset impairments | 2 | | 12 | |
| Restructuring expenses | 4 | | 10 | |
| Reimbursement from Escrow Account | 6 | | 12 | |
| Loss from discontinued operations, net of tax | $ 7 | $ 2 | $ 24 | $ 7 |

**NOTE 4. Asset Impairments**

Statement of Financial Accounting Standards No. 144 ( SFAS 144 ), Accounting for the Impairment or Disposal of Long-Lived Assets requires that long-lived assets and intangible assets subject to amortization are reviewed for impairment when certain indicators of impairment are present. Impairment exists if estimated future undiscounted cash flows associated with long-lived assets are not sufficient to recover the carrying value of such assets. When impairment exists the long-lived assets are adjusted to their respective fair values.

*2007 Asset Impairments*

The Company recorded asset impairment charges of $11 million and $51 million during the three and six month periods ended June 30, 2007. These impairment charges were recorded to adjust the carrying value of associated long-lived assets to their estimated fair value in accordance with SFAS 144.

During the first quarter of 2007, the Company determined that assets subject to the Chassis Divestiture including inventory, intellectual property, and real and personal property met the held for sale criteria of SFAS 144. Accordingly, these assets were valued at the lower of carrying amount or fair value less cost to sell, which resulted in asset impairment charges of approximately $8 million and $25 million for the three and six month periods ended June 30, 2007, respectively. Approximately $14 million of assets related to the Chassis Divestiture are classified as assets held for sale in the consolidated balance sheets as of June 30, 2007.

In consideration of the MASPA and the Company s announced exit of the brake manufacturing business at its chassis facility located in Swansea, Wales, U.K., an asset impairment charge of $16 million was recorded to reduce the net book value of certain long-lived assets at the facility to their estimated fair value in the first quarter. The Company s estimate of fair value was based on market prices, prices of similar assets, and other available information.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 4. Asset Impairments (Continued)**

During the first quarter of 2007, the Company entered into an agreement to sell an Electronics building located in Hiroshima, Japan. The Company determined that this building met the held for sale criteria of SFAS 144 as of March 31, 2007 and was recorded at the lower of carrying value or fair value less cost to sell, which resulted in an asset impairment charge of approximately $7 million. The Company expects the sale of the building to close during the second half of 2007. Approximately $4 million related to the Electronics building located in Hiroshima, Japan is classified as assets held for sale in the consolidated balance sheets as of June 30, 2007.

In connection with restructuring activities undertaken at a North American Other facility, the Company recorded an asset impairment of $3 million to reduce the net book value of certain long-lived assets to their estimated fair value during the three-months ended June 30, 2007.

*2006 Asset Impairments*

The Company recorded asset impairment charges of $22 million during the three month period ended June 30, 2006. These impairment charges were recorded to adjust the carrying value of associated long-lived assets to their estimated fair value in accordance with SFAS 144.

Vitro Flex, S.A. de C.V. ( Vitro Flex ), a Mexican corporation, is a joint venture which was 38% owned by the Company and its subsidiaries. Vitro Flex manufactures and supplies tempered and laminated glass for use in automotive vehicles. In accordance with APB 18, the Company determined that an other than temporary decline in the fair market value of this investment occurred. Consequently, the Company reduced the carrying value of its investment in Vitro Flex by approximately $12 million to its estimated fair market value at June 30, 2006.

In connection with restructuring activities undertaken at a European Interiors facility, the Company recorded an asset impairment of $10 million to reduce the net book value of certain long-lived assets to their estimated fair value during the three-months ended June 30, 2006.

**NOTE 5. Restructuring Activities**

The Company has undertaken various restructuring activities to achieve its strategic objectives, including the reduction of operating costs. Restructuring activities include, but are not limited to, plant closures, relocation of production, administrative realignment and consolidation of available capacity and resources. Management expects to finance restructuring programs principally through cash reimbursement from an escrow account established pursuant to the October 1, 2005 transaction whereby Ford acquired all of the issued and outstanding shares of common stock of the parent of Automotive Components Holdings, LLC ( ACH ). To the extent that the Company s restructuring activities require cash in connection with or beyond that provided by the Escrow Agreement, the Company expects to use cash generated from its ongoing operations, or cash available under its existing debt agreements, subject to the terms of applicable covenants. The Company does not expect that the execution of these programs will have a significant adverse impact on its liquidity position.

*Escrow Agreement*

Pursuant to the Escrow Agreement, dated as of October 1, 2005, among the Company, Ford and Deutsche Bank Trust Company Americas, Ford paid $400 million into an escrow account for use by the Company to restructure its businesses. The Escrow Agreement provides that the Company will be reimbursed from the escrow account for the first $250 million of reimbursable restructuring costs, as defined in the Escrow Agreement, and up to one half of the next $300 million of such costs. Cash in the escrow account is invested at the direction of the Company, in high quality, short-term investments and related investment earnings are credited to the account as earned. Investment earnings become available to reimburse the Company s restructuring costs following the use of the first $250 million of available funds.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 5. Restructuring Activities (Continued)**

The following table provides a reconciliation of amounts available in the escrow account.

| | Three-Months Ended June 30, 2007 | Six-Months Ended June 30, 2007 | Inception through June 30, 2007 |
|---|---|---|---|
| | | (Dollars in Millions) | |
| Beginning escrow account available | $ 268 | $ 319 | $ 400 |
| Add: Investment earnings | 3 | 7 | 27 |
| Deduct: Disbursements for restructuring costs | (52) | (107) | (208) |
| Ending escrow account available | $ 219 | $ 219 | $ 219 |

As of June 30, 2007 and December 31, 2006, approximately $42 million and $55 million, respectively, of amounts receivable from the escrow account were included in the consolidated balance sheets.

*Restructuring Reserves*

The following is a summary of the Company s consolidated restructuring reserves and related activity as of and for the three and six-month periods ended June 30, 2007. Substantially all of the Company s restructuring expenses are related to employee severance and termination benefit costs. Restructuring expenses included in the table below include $4 million and $10 million related to discontinued operations for the three and six month periods ended June 30, 2007. Such expenses are included in Loss from discontinued operations, net of tax on the consolidated statements of operations.

| | Interiors | Climate | Electronics | Other | Total |
|---|---|---|---|---|---|
| | | | (Dollars in Millions) | | |
| December 31, 2006 | $ 18 | $ 21 | $ 2 | $ 12 | $ 53 |
| Expenses | | | 6 | 25 | 31 |
| Utilization | (5) | (3) | (1) | (13) | (22) |
| March 31, 2007 | 13 | 18 | 7 | 24 | 62 |
| Expenses | 15 | 13 | 1 | 12 | 41 |
| Utilization | (8) | (3) | (1) | (19) | (31) |
| June 30, 2007 | $ 20 | $ 28 | $ 7 | $ 17 | $ 72 |

*2007 Restructuring Actions*

During the three-months ended June 30, 2007 the Company recorded restructuring expenses of approximately $41 million under the previously announced multi-year improvement plan, including the following significant actions:

The Company recorded $10 million of employee severance and termination benefit costs for approximately 150 employees at a European Interiors facility related to the planned transfer of production to other facilities.

Approximately $8 million of employee severance and termination benefit costs were recorded for approximately 40 hourly and 20 salaried employees at various European facilities.

The Company recorded $7 million related to the previously announced closure of a North American Climate facility. Of this amount, $6 million relates to employee severance and termination benefits and the remaining $1 million is for lease termination costs.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 5. Restructuring Activities (Continued)**

The Company continues to evaluate its general and administrative support infrastructure and continues to reduce such costs as related to restructuring actions taken under the multi-year improvement plan. As a result, $6 million of employee severance and termination benefit costs were recorded related to approximately 55 salaried employees.

The Company recorded $4 million of employee severance and termination benefit charges related to the Company s previously announced exit of its brake manufacturing business at a European Other facility. The charges relate to approximately 85 hourly and 15 salaried employees. These expenses are classified as Loss from discontinued operations, net of tax on the consolidated statements of operations.

The Company recorded an estimate of employee severance and termination benefit costs of approximately $4 million for the probable payment of such post-employment benefits in connection with the multi-year improvement plan.

The Company has incurred $185 million in cumulative restructuring costs related to the multi-year improvement plan including $74 million, $44 million, $39 million and $28 million for the Other, Climate, Interiors and Electronics product groups, respectively. Substantially all restructuring expenses recorded to date relate to employee severance and termination benefit costs and are classified as Restructuring expenses on the consolidated statements of operations. As of June 30, 2007, the restructuring reserve balance of $72 million is entirely attributable to the multi-year improvement plan.

The Company currently estimates that the total cash cost associated with this multi-year improvement plan will be approximately $430 million. The Company continues to achieve targeted cost reductions associated with the multi-year improvement plan at a lower cost than expected due to higher levels of employee attrition and lower per employee severance cost resulting from changes to certain employee benefit plans. The Company anticipates that approximately $350 million of cash costs incurred under the multi-year improvement plan will be reimbursed from the escrow account pursuant to the terms of the Escrow Agreement. While the Company anticipates full utilization of funds available under the Escrow Agreement, any amounts remaining in the escrow account after December 31, 2012 will be disbursed to the Company pursuant to the terms of the Escrow Agreement. It is possible that actual cash restructuring costs could vary significantly from the Company s current estimates resulting in unexpected costs in future periods. Generally, charges are recorded as elements of the plan are finalized and the timing of activities and the amount of related costs are not likely to change.

**NOTE 6. Extraordinary Item**

On April 27, 2006 the Company s wholly-owned, consolidated subsidiary Carplastic, S.A. de C.V. acquired the real property, inventory, tooling and equipment of Guide Lighting Technologies of Mexico S. de R.L. de C.V., a lighting manufacturing facility located in Monterrey, Mexico.

In accordance with Statement of Financial Accounting Standards No. 141 Business Combinations, the Company allocated the purchase price to the assets and liabilities acquired. The sum of the amounts assigned to the assets and liabilities acquired exceeded the cost of the acquired entity and that excess was allocated as a pro rata reduction of the amounts that otherwise would have been assigned to all of the acquired non-financial assets (i.e. property and

equipment). An excess of $8 million remained after reducing to zero the amounts that otherwise would have been assigned to the non-financial assets and was recorded as an extraordinary gain in the accompanying consolidated financial statements.

**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 7. Stock-Based Compensation**

During the three-months ended June 30, 2007, the Company granted stock-based compensation as follows:

Approximately 27,000 stock options, 47,000 stock appreciation rights ( SARs ), and 200,000 restricted stock units ( RSUs ) under the 2004 Visteon Incentive Compensation Plan. As of June 30, 2007, there were approximately 7 million shares of common stock available for grant under this plan.

Approximately 16,000 restricted stock awards ( RSAs ) under the Visteon Corporation Employees Equity Incentive Plan. As of June 30, 2007, there were approximately 1 million shares of common stock available for grant under this plan.

Weighted average assumptions used to estimate the fair value of stock-based compensation awards during the three-months ended June 30, 2007 were as follows:

| | Three-Months Ended June 30, 2007 | |
|---|---|---|
| | **SARS** | **Stock Options** |
| Expected term (in years) | 5.52 | 4-6 |
| Risk-free interest rate | 4.89% | 4.68%-4.70% |
| Expected volatility | 58% | 59% |
| Expected dividend yield | 0.0% | 0.0% |

Effective January 1, 2006 the Company adopted Statement of Financial Accounting Standards No. 123 (Revised 2004) ( SFAS 123(R) ), Share-Based Payments , using the modified-prospective method. The cumulative effect, net of tax, of adopting SFAS 123(R) was $4 million or $0.03 per share as of January 1, 2006.

**NOTE 8. Asset Securitization**

Effective August 14, 2006, the Company entered into a European accounts receivable securitization facility ( European Securitization ) that extends until August 2011 and provides up to $325 million in funding from the sale of certain customer trade account receivables originating from Company subsidiaries located in Germany, Portugal, Spain, France and the U.K. ( Sellers ). Under the European Securitization, receivables originated by the Sellers and certain of their subsidiaries are transferred to Visteon Financial Centre P.L.C. (the Transferor ). The Transferor is a bankruptcy-remote qualifying special purpose entity. Receivables transferred from the Sellers are funded through cash obtained from the issuance of variable loan notes to third-party lenders and through subordinated loans obtained from a wholly-owned subsidiary of the Company, which represent the Company s retained interest in the receivables transferred.

Transfers under the European Securitization, for which the Company receives consideration other than a beneficial interest, are accounted for as true sales under the provisions of Statement of Financial Accounting Standards No. 140 ( SFAS 140 ), Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities and are removed from the balance sheet. Transfers under the European Securitization, for which the Company receives a

beneficial interest are not removed from the balance sheet and total $551 million and $482 million as of June 30, 2007 and December 31, 2006, respectively. Such amounts are recorded at fair value and are subordinated to the interests of third-party lenders. Securities representing the Company s retained interests are accounted for as trading securities under Statement of Financial Accounting Standards No. 115 Accounting for Certain Investments in Debt and Equity Securities.

Availability of funding under the European Securitization depends primarily upon the amount of trade account receivables, reduced by outstanding borrowings under the program and other characteristics of



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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 8. Asset Securitization (Continued)**

those receivables that affect their eligibility (such as bankruptcy or the grade of the obligor, delinquency and excessive concentration). As of June 30, 2007, approximately $325 million of the Company s transferred receivables were considered eligible for borrowing under this facility, $92 million was outstanding and $233 million was available for funding. The Company recorded losses of $3 million and $4 million for the three and six-month periods ended June 30, 2007 related to receivables sold under the European Securitization.

The table below provides a reconciliation of the change in interests in account receivables transferred for the period.

| | Three-Months Ended June 30, 2007 | Six-Months Ended June 30, 2007 |
|---|---|---|
| | (Dollars in Millions) | |
| Beginning balance | $ 574 | $ 482 |
| Receivables transferred | 865 | 1,889 |
| Proceeds from new securitizations | | (41) |
| Proceeds from collections reinvested in securitization | (116) | (257) |
| Cash flows received on interests retained | (772) | (1,522) |
| Ending balance | $ 551 | $ 551 |

**NOTE 9. Inventories**

Inventories are stated at the lower of cost, determined on a first-in, first-out basis, or market. A summary of inventories is provided below:

| | June 30 2007 | December 31 2006 |
|---|---|---|
| | (Dollars in Millions) | |
| Raw materials | $ 155 | $ 154 |
| Work-in-process | 251 | 266 |
| Finished products | 171 | 157 |
| | 577 | 577 |
| Valuation reserves | (54) | (57) |
| | $ 523 | $ 520 |

**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

## NOTE 10. Other Assets

Other current assets are summarized as follows:

| | June 30 2007 | December 31 2006 |
|---|---|---|
| | (Dollars in Millions) | |
| Recoverable taxes | $ 123 | $ 95 |
| Current deferred tax assets | 49 | 47 |
| Escrow receivable | 42 | 55 |
| Prepaid assets | 27 | 22 |
| Customer deposits | 25 | 23 |
| Other | 18 | 19 |
| | $ 284 | $ 261 |

Other non-current assets are summarized as follows:

| | June 30 2007 | December 31 2006 |
|---|---|---|
| | (Dollars in Millions) | |
| Non-current deferred tax assets | $ 48 | $ 45 |
| Unamortized debt costs and other intangible assets | 36 | 35 |
| Assets held for sale | 27 | |
| Notes receivable | 11 | 13 |
| Other | 21 | 22 |
| | $ 143 | $ 115 |

## NOTE 11. Non-Consolidated Affiliates

The Company had $215 million and $224 million of equity in the net assets of non-consolidated affiliates at June 30, 2007 and December 31, 2006, respectively. The Company recorded equity in net income of non-consolidated affiliates of $14 million and $12 million for the three-month periods ended June 30, 2007 and 2006. For the six-month periods ended June 30, 2007 and 2006, the Company recorded $23 million and $19 million, respectively. The following table presents summarized financial data for the Company s non-consolidated affiliates. The amounts included in the table below represent 100% of the results of operations of the Company s non-consolidated affiliates accounted for under the equity method. Yanfeng Visteon Automotive Trim Systems Co., Ltd ( Yanfeng ), of which the Company owns a 50% interest, is considered a significant non-consolidated affiliate and is shown separately below.

Summarized financial data for the three-month period ended June 30 are as follows:

| | Net Sales | | Gross Margin | | Net Income | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | | | |
| Yanfeng Visteon Automotive Trim Systems Co., Ltd. | $ 248 | $ 168 | $ 46 | $ 29 | $ 21 | $ 14 |
| All other | 179 | 194 | 30 | 35 | 7 | 10 |
| | $ 427 | $ 362 | $ 76 | $ 64 | $ 28 | $ 24 |

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VISTEON CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**NOTE 11. Non-Consolidated Affiliates (Continued)**

Summarized financial data for the six-month period ended June 30 are as follows:

| | Net Sales | | Gross Margin | | Net Income | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | | | |
| Yanfeng Visteon Automotive Trim Systems Co., Ltd. | $ 438 | $ 324 | $ 77 | $ 56 | $ 34 | $ 25 |
| All other | 348 | 331 | 53 | 50 | 12 | 13 |
| | $ 786 | $ 655 | $ 130 | $ 106 | $ 46 | $ 38 |

The Company s share of net assets and net income is reported in the consolidated financial statements as Equity in net assets of non-consolidated affiliates on the consolidated balance sheets and Equity in net income of non-consolidated affiliates on the consolidated statements of operations. Included in the Company s accumulated deficit is undistributed income of non-consolidated affiliates accounted for under the equity method of approximately $109 million and $123 million at June 30, 2007 and December 31, 2006, respectively.

**NOTE 12. Property and Equipment**

Property and equipment is stated at cost. Depreciable property is depreciated over the estimated useful lives of the assets, principally using the straight-line method. A summary of property and equipment, net is provided below:

| | June 30 2007 | December 31 2006 |
|---|---|---|
| | (Dollars in Millions) | |
| Land | $ 109 | $ 112 |
| Buildings and improvements | 1,110 | 1,221 |
| Machinery, equipment and other | 3,788 | 4,065 |
| Construction in progress | 111 | 125 |
| Total property and equipment | 5,118 | 5,523 |
| Accumulated depreciation | (2,477) | (2,653) |
| | 2,641 | 2,870 |
| Product tooling, net of amortization | 149 | 164 |
| Property and equipment, net | $ 2,790 | $ 3,034 |

Depreciation and amortization expenses are summarized as follows:

| | Three-Months Ended June 30 | | Six-Months Ended June 30 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | |
| Depreciation | $ 104 | $ 93 | $ 212 | $ 181 |
| Amortization | 12 | 13 | 25 | 27 |
| | $ 116 | $ 106 | $ 237 | $ 208 |

The Company recorded approximately $12 million and $22 million of accelerated depreciation expense for the three and six months ended June 30, 2007, respectively, representing the shortening of estimated useful lives of certain assets (primarily machinery and equipment) in connection with the Company s restructuring activities.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 13. Other Liabilities**

Other current liabilities are summarized as follows:

| | June 30 2007 | December 31 2006 |
|---|---|---|
| | (Dollars in Millions) | |
| Restructuring reserves | $ 72 | $ 53 |
| Interest | 62 | 53 |
| Product warranty and recall | 53 | 53 |
| Value added taxes payable | 34 | 17 |
| Income taxes payable | 20 | 23 |
| Non-income tax liabilities | 17 | 14 |
| Deposits | 11 | 6 |
| Deferred income taxes | 9 | 8 |
| Legal and environmental | 6 | 7 |
| Other accrued liabilities | 92 | 86 |
| | $ 376 | $ 320 |

Other non-current liabilities are summarized as follows:

| | June 30 2007 | December 31 2006 |
|---|---|---|
| | (Dollars in Millions) | |
| Non-income tax liabilities | $ 95 | $ 106 |
| Product warranty and recall | 53 | 52 |
| Deferred income | 60 | 56 |
| Other | 155 | 104 |
| | $ 363 | $ 318 |

**NOTE 14. Debt**

Short-term and long-term debt, including the fair market value of related interest rate swaps, were as follows:

| | June 30 | December 31 |
|---|---|---|

| | 2007 | 2006 |
|---|---|---|
| | (Dollars in Millions) | |
| **Short-term debt** | | |
| Current portion of long-term debt | $ 37 | $ 31 |
| Other short-term | 63 | 69 |
| Total short-term debt | 100 | 100 |
| **Long-term debt** | | |
| 8.25% notes due August 1, 2010 | 548 | 550 |
| Term loan due June 13, 2013 | 1,000 | 1,000 |
| Term loan due December 13, 2013 | 500 | |
| 7.00% notes due March 10, 2014 | 435 | 439 |
| Other | 122 | 139 |
| Total long-term debt | 2,605 | 2,128 |
| Total debt | $ 2,705 | $ 2,228 |

**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 14. Debt (Continued)**

On April 10, 2007, the Company entered into an Agreement to amend and restate its Credit Agreement ( Amended Credit Agreement ) to provide an additional $500 million secured term loan. Consistent with the existing term loan, the additional term loan will bear interest at a Eurodollar rate plus 3% and will mature on December 13, 2013.

**NOTE 15. Employee Retirement Benefits**

Statement of Financial Accounting Standards No. 158 ( SFAS 158 ), Employers Accounting for Defined Benefit Pension and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, 106, and 132(R) requires recognition of a net asset or liability representing the funded status of defined benefit pension and other postretirement benefit ( OPEB ) plans. In addition, SFAS 158 requires companies to measure plan assets and benefit obligations as of the date of the employer s fiscal year-end balance sheet. The Company adopted the recognition and disclosure provisions of SFAS 158 as of December 31, 2006 and the measurement provisions of this standard as of January 1, 2007.

The Company re-measured plan assets and obligations as of January 1, 2007 consistent with the provisions of SFAS 158. As a result of the SFAS 158 re-measurement, the Company recorded a reduction to the pension liability of approximately $100 million, a reduction of the OPEB liability of approximately $90 million and an increase to accumulated other comprehensive income of approximately $190 million. The Company also adjusted the January 1, 2007 retained earnings balance by approximately $33 million, representing the net periodic benefit costs for the period between September 30, 2006 and January 1, 2007 that would have been recognized on a delayed basis during the first quarter of 2007 absent the change in measurement date. The net periodic benefit costs for 2007 are based on this January 1, 2007 measurement or subsequent re-measurements.

The components of the Company s net periodic benefit costs for the three-month periods ended June 30, 2007 and June 30, 2006 were as follows:

| | Retirement Plans | | | | Health Care and Life Insurance Benefits | |
|---|---|---|---|---|---|---|
| | U.S. Plans | | Non-U.S. Plans | | | |
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | | | |
| Service cost | $ 6 | $ 13 | $ 6 | $ 8 | $ 1 | $ 4 |
| Interest cost | 18 | 18 | 17 | 16 | 8 | 10 |
| Expected return on plan assets | (19) | (18) | (13) | (12) | | |
| Amortization of: | | | | | | |
| Plan amendments | | 1 | 2 | 2 | (12) | (12) |
| Actuarial losses and other | 1 | 2 | 3 | 5 | 4 | 7 |
| Special termination benefits | | 1 | | | | |
| Settlements | | | 13 | | | |
| Curtailments | | (11) | | | (3) | (37) |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Visteon sponsored plan net periodic benefit costs | | 6 | | 6 | | 28 | | 19 | | (2) | | (28) |
| Expense for Visteon-assigned Ford-UAW and certain salaried employees | | | | | | | | | | (1) | | (3) |
| Net periodic benefits costs, excluding restructuring | $ | 6 | $ | 6 | $ | 28 | $ | 19 | $ | (3) | $ | (31) |
| Special termination benefits | | 1 | | | | 8 | | | | | | |
| Total employee retirement benefit related restructuring costs | $ | 1 | $ | | $ | 8 | $ | | $ | | $ | |

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 15. Employee Retirement Benefits (Continued)**

The components of the Company s net periodic benefit costs for the six-month periods ended June 30, 2007 and June 30, 2006 were as follows:

| | Retirement Plans | | | | Health Care and Life Insurance Benefits | |
|---|---|---|---|---|---|---|
| | U.S. Plans | | Non-U.S. Plans | | | |
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | | | |
| Service cost | $ 13 | $ 29 | $ 14 | $ 17 | $ 3 | $ 8 |
| Interest cost | 36 | 37 | 36 | 33 | 16 | 21 |
| Expected return on plan assets | (38) | (36) | (27) | (25) | | |
| Amortization of: | | | | | | |
| Plan amendments | 1 | 3 | 3 | 3 | (23) | (25) |
| Actuarial losses and other | 1 | 3 | 6 | 10 | 8 | 14 |
| Special termination benefits | | 1 | | | | |
| Settlements | | | 30 | | | |
| Curtailments | 10 | (11) | | (1) | (9) | (37) |
| Visteon sponsored plan net periodic benefit costs | 23 | 26 | 62 | 37 | (5) | (19) |
| Expense for Visteon-assigned Ford-UAW and certain salaried employees | | (3) | | | (2) | (28) |
| Net periodic benefits costs, excluding restructuring | $ 23 | $ 23 | $ 62 | $ 37 | $ (7) | $ (47) |
| Special termination benefits | 3 | | 8 | | | |
| Total employee retirement benefit related restructuring costs | $ 3 | $ | $ 8 | $ | $ | $ |

*Curtailments and Settlements*

Curtailment and settlement gains and losses are recorded in accordance with Statement of Financial Accounting Standards Nos. 88 ( SFAS 88 ), Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits , and 106 ( SFAS 106 ), Employers Accounting for Postretirement Benefits Other Than Pensions and are classified in the Company s consolidated statements of operations as Cost of sales or Selling, general and administrative expenses . Qualifying curtailment and settlement losses related to the Company s restructuring activities are reimbursable under the terms of the Escrow Agreement. The Company recorded curtailments and settlements as follows:

The Company recorded curtailment gains of $3 million and $9 million for the three and six months ended June 30, 2007 related to elimination of employee benefits associated with a U.S. OPEB plan in connection with employee headcount reductions under previously announced restructuring actions.

The Company recorded a settlement loss of $13 million during the three-months ended June 30, 2007 related to employee retirement benefit obligations under certain German retirement plans for employees of the Dueren and Wuelfrath, Germany facilities, which were included in the Chassis Divestiture.

The Company recorded curtailment gains during the second quarter of 2006 of $37 million and $11 million related to the reduction in expected years of future service in Visteon sponsored OPEB and retirement plans, respectively. The reduction in future service resulted from the transfer of Company employees to Ford in connection with their January 1, 2006 acquisition of two plants from ACH located in Rawsonville, MI and Sterling Heights, MI ( Rawsonville-Sterling Transaction ).

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 15. Employee Retirement Benefits (Continued)**

The Company recorded a settlement loss of $17 million during the three-months ended March 31, 2007 related to employee retirement benefit obligations under a Canadian retirement plan for employees of the Markham, Ontario facility, which was closed in 2002.

The Company recorded a curtailment loss of $10 million for the three month period ended March 31, 2007 related to employee retirement benefit obligations under certain U.S. retirement plans in connection with previously announced restructuring actions.

As of June 30, 2007, the Company expects to record curtailment gains of approximately $77 million for retiree health plans in future periods as employees are terminated in connection with the multi-year improvement plan.

*Retirement Benefit Related Restructuring Expenses*

In addition to retirement benefit expenses, the Company recorded $9 million and $11 million for the three and six months ended June 30, 2007, respectively, for retirement benefit related restructuring charges. Such charges generally relate to special termination benefits, voluntary termination incentives, and pension losses and are the result of various restructuring actions as described in Note 5 Restructuring Activities . Retirement benefit related restructuring charges are recorded in accordance with SFAS 87, 88, 106, 112 and 158, are initially classified as restructuring expenses and related reserves are subsequently reclassified to retirement benefit liabilities.

*Contributions*

During the six-month period ended June 30, 2007, contributions to the Company s U.S. retirement plans and postretirement health care and life insurance plans were $16 million and $12 million, respectively, and contributions to non-U.S. retirement plans were $47 million. The Company presently anticipates additional contributions to its U.S. retirement plans and postretirement health care and life insurance plans of $36 million and $17 million, respectively, in 2007. The Company also anticipates additional 2007 contributions to non-U.S. retirement plans of $32 million.

*Other*

During the six-months ended June 30, 2007, the Company recorded a reduction of its pension liability of approximately $100 million, a reduction of its OPEB liability of approximately $30 million, and an increase in accumulated other comprehensive income of approximately $130 million. These adjustments were due to a U.S. salaried plan amendment which reduced disability retirement benefits, the elimination of future benefits under German pension plans resulting from the sale of chassis operations located in Dueren and Wuelfrath, Germany and other pension and OPEB plans affected by actions under the multi-year improvement plan.

During the six-months ended June 30, 2006, the Company recorded a reduction in its postretirement benefit payable to Ford of approximately $24 million. This reduction resulted from the transfer of Company employees to Ford in connection with the Rawsonville-Sterling Transaction.

**NOTE 16. Income Taxes**

*Adoption of FIN 48*

Effective January 1, 2007, the Company adopted FIN 48, which establishes a single model to address accounting for uncertain tax positions and clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The adoption of FIN 48 did not have a material impact on the Company s consolidated financial statements.

**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 16. Income Taxes (Continued)**

In connection with the adoption of FIN 48 and beginning January 1, 2007, the Company classified all interest and penalties as income tax expense. Prior to the adoption of FIN 48, the Company s policy was to record interest and penalties related to income tax contingencies as a component of income before taxes. Accrued interest and penalties was $20 million at January 1, 2007. Estimated interest and penalties related to the underpayment of income taxes totaled approximately $2 million for the six-months ended June 30, 2007.

*Unrecognized Tax Benefits*

The Company and its subsidiaries have operations in every major geographic region of the world and are subject to income taxes in the U.S. and numerous foreign jurisdictions. Accordingly, the Company files tax returns and is subject to examination by taxing authorities throughout the world, including such significant jurisdictions as Korea, India, Portugal, Spain, Czech Republic, Canada, Germany and the United States. With few exceptions, the Company is no longer subject to U.S. federal tax examinations for years before 2004 or state and local, or non-U.S. income tax examinations for years before 2000.

The Company s gross unrecognized tax benefits as of January 1 were approximately $150 million, of which approximately $55 million would impact the effective tax rate if recognized. The gross unrecognized tax benefits differs from that which would impact the effective tax rate due to uncertain tax positions embedded in other deferred tax attributes carrying a full valuation allowance. Since the uncertainty is expected to be resolved while a full valuation allowance is maintained, these uncertain tax positions will not impact the effective tax rate in current or future periods.

During the second quarter of 2007, the Company increased its unrecognized tax benefits through income tax expense by approximately $17 million primarily as a result of certain positions taken in tax returns filed in the quarter, as well as those expected to be taken in future tax returns in certain non-U.S. jurisdictions.

It is reasonably possible that the amount of the Company s unrecognized tax benefits may change within the next twelve months as a result of settlement of ongoing audits or for positions expected to be taken in future tax returns, primarily related to transfer pricing-related initiatives. An estimate of the range of reasonably possible outcomes, however, cannot be made at this time. Further, substantially all of the Company s unrecognized tax benefits relate to uncertain tax positions that are not currently under review by taxing authorities and therefore, the Company is unable to specify the future periods in which it may be obligated to settle such amounts.

*Provision for Income Taxes*

The Company s provision for income taxes in interim periods is computed by applying an estimated annual effective tax rate against income (loss) before income taxes, excluding related equity in net income of affiliated companies, for the period. Effective tax rates vary from period to period as separate calculations are performed for those countries where the Company s operations are profitable and whose results continue to be tax-effected and for those countries where full deferred tax valuation allowances exist and are maintained.

The Company s provisions for income taxes of $28 million and $45 million for the three and six-month periods ended June 30, 2007 reflects income tax expense related to those countries where the Company is profitable, accrued

withholding taxes and certain non-recurring and other discrete tax items. Additionally, the provision also reflects the Company s inability to record a tax benefit for pre-tax losses in the U.S. and certain foreign countries to the extent not offset by other categories of income.

SFAS 109 generally requires that the amount of tax expense or benefit allocated to continuing operations be determined without regard to the tax effects of other categories of income or loss, such as other comprehensive income. However, an exception to the general rule is provided when there is a pre-tax loss

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 16. Income Taxes (Continued)**

from continuing operations and net pre-tax income from other categories in the current year. In such instances, net pre-tax income from other categories must offset the current loss from operations, the tax benefit of such offset being reflected in continuing operations even when a valuation allowance has been established against the deferred tax assets. In instances where a valuation allowance is established against current year operating losses, net pre-tax income from other sources, including other comprehensive income, is considered when determining whether sufficient future taxable income exists to realize the deferred tax assets. During the three and six months ended June 30, 2007, net pre-tax income from other categories of income or loss, in particular, pre-tax other comprehensive income primarily attributable to re-measurement of pension and OPEB plans in the U.S. and Germany, offset approximately $54 million and $77 million, respectively of pre-tax operating losses in the U.S. and Germany, reducing the Company s current period valuation allowance resulting in a benefit of $19 million and $27 million allocated to the current year loss from continuing operations for the three and six months ended June 30, 2007, respectively.

The need to maintain valuation allowances against deferred tax assets in the U.S. and other affected countries will continue to cause variability in the Company s quarterly and annual effective tax rates. Full valuation allowances against deferred tax assets in the U.S. and applicable foreign countries, which include the U.K. and Germany, will be maintained until sufficient positive evidence exists to reduce or eliminate them.

**NOTE 17. Comprehensive Income (Loss)**

Comprehensive income (loss), net of tax is summarized below:

| | Three-Months Ended June 30 | | Six-Months Ended June 30 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | |
| Net (loss) income | $ (67) | $ 50 | $ (220) | $ 53 |
| Pension and other postretirement benefit adjustments | 44 | | 109 | |
| Change in foreign currency translation adjustments | 22 | 28 | 32 | 64 |
| Unrealized gains/(losses) on derivatives | 1 | (7) | (2) | (11) |
| | $ | $ 71 | $ (81) | $ 106 |

Accumulated other comprehensive income (loss) is comprised of the following:

| | June 30 2007 | December 31 2006 |
|---|---|---|
| | (Dollars in Millions) | |

| | | |
|---|---|---|
| Foreign currency translation adjustments | $ 198 | $ 166 |
| Pension and other postretirement benefit adjustments, net of tax | (79) | (378) |
| Unrealized gains/(losses) on derivatives | (6) | (4) |
| | $ 113 | $ (216) |

**NOTE 18. (Loss) Earnings Per Share**

Basic (loss) earnings per share of common stock is calculated by dividing reported net (loss) income by the average number of shares of common stock outstanding during the applicable period, adjusted for restricted stock. The calculation of diluted (loss) earnings per share takes into account the effect of

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 18. (Loss) Earnings Per Share (Continued)**

dilutive potential common stock, such as stock options, and contingently returnable shares, such as restricted stock.

| | Three-Months Ended June 30 | | Six-Months Ended June 30 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | |
| Numerator: | | | | |
| Net (loss) income from continuing operations before change in accounting and extraordinary item | $ (60) | $ 44 | $ (196) | $ 56 |
| Loss from discontinued operations, net of tax | 7 | 2 | 24 | 7 |
| Net (loss) income before change in accounting and extraordinary item | $ (67) | $ 42 | $ (220) | $ 49 |
| Cumulative effect of change in accounting, net of tax | | | | (4) |
| Net (loss) income before extraordinary item | (67) | 42 | (220) | 45 |
| Extraordinary item, net of tax | | 8 | | 8 |
| Net (loss) income | $ (67) | $ 50 | $ (220) | $ 53 |
| Denominator: | | | | |
| Average common stock outstanding | 129.6 | 128.0 | 129.3 | 128.2 |
| Less: Average restricted stock outstanding | (0.1) | (0.2) | (0.1) | (0.7) |
| Basic shares | 129.5 | 127.8 | 129.2 | 127.5 |
| Net dilutive effect of restricted stock | | 0.1 | | 0.1 |
| Diluted shares | 129.5 | 127.9 | 129.2 | 127.6 |
| Per Share Data: | | | | |
| Basic and diluted (loss) earnings per share from continuing operations before change in accounting and extraordinary item | $ (0.46) | $ 0.34 | $ (1.52) | $ 0.44 |
| Loss from discontinued operations, net of tax | (0.06) | (0.01) | (0.18) | (0.06) |
| Basic and diluted (loss) earnings per share before change in accounting and extraordinary item | $ (0.52) | $ 0.33 | $ (1.70) | $ 0.38 |
| Cumulative effect of change in accounting, net of tax | | | | (0.03) |
| Basic and diluted (loss) earnings per share before extraordinary item | (0.52) | 0.33 | (1.70) | 0.35 |
| Extraordinary item, net of tax | | 0.06 | | 0.06 |

| | | | | |
|---|---|---|---|---|
| Basic and diluted (loss) earnings per share | $ (0.52) | $ 0.39 | $ (1.70) | $ 0.41 |

Stock options to purchase approximately 13 million shares of common stock and warrants to purchase 25 million shares of common stock were not included in the computation of diluted loss per share because the effect of including them would have been anti-dilutive for the three and six-months ended June 30, 2007.

**NOTE 19. Commitments and Contingencies**

*Guarantees*

The Company has guaranteed approximately $65 million and $77 million of debt capacity held by consolidated and unconsolidated subsidiaries and $98 million and $97 million for lifetime lease payments held by consolidated subsidiaries at June 30, 2007 and December 31, 2006, respectively. In addition, the

**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 19. Commitments and Contingencies (Continued)**

Company has guaranteed certain Tier 2 suppliers debt and lease obligations and other third-party service providers obligations of up to $6 million and $17 million at June 30, 2007 and December 31, 2006 respectively, to ensure the continued supply of essential parts.

*Litigation and Claims*

In February 2005, a shareholder lawsuit was filed in the U.S. District Court for the Eastern District of Michigan against the Company and certain current and former officers of the Company. In July 2005, the Public Employees Retirement System of Mississippi was appointed as lead plaintiff in this matter. In September 2005, the lead plaintiff filed an amended complaint, which alleges, among other things, that the Company and its independent registered public accounting firm, PricewaterhouseCoopers LLP, made misleading statements of material fact or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. The named plaintiff seeks to represent a class consisting of purchasers of the Company s securities during the period between June 28, 2000 and January 31, 2005. Class action status has not yet been certified in this litigation. On August 31, 2006, the defendants motion to dismiss the amended complaint for failure to state a claim was granted. The plaintiffs have appealed this decision.

In March 2005, a number of current and former directors and officers were named as defendants in two shareholder derivative suits pending in the State of Michigan Circuit Court for the County of Wayne. As is customary in derivative suits, the Company has been named as a defendant in these actions. As a nominal defendant, the Company is not liable for any damages in these suits nor is any specific relief sought against the Company. The complaints allege that, among other things, the individual defendants breached their fiduciary duties of good faith and loyalty and aided and abetted such breaches during the period between January 23, 2004 and January 31, 2005 in connection with the Company s conduct concerning, among other things, the matters alleged in the securities class action discussed immediately above. The derivative matters have been stayed pending resolution of defendants motion to dismiss the securities matter pending in the Eastern District of Michigan and any related appeal.

In March and April 2005, the Company and a number of current and former employees, officers and directors were named as defendants in three class action lawsuits brought under the Employee Retirement Income Security Act ( ERISA ) in the U.S. District Court for the Eastern District of Michigan. In September 2005, the plaintiffs filed an amended and consolidated complaint, which generally alleged that the defendants breached their fiduciary duties under ERISA during the class period by, among other things, continuing to offer Visteon stock as an investment alternative under the Visteon Investment Plan (and the Visteon Savings Plan for Hourly Employees, together the Plans ), failing to disclose complete and accurate information regarding the prudence of investing in Visteon stock, failing to monitor the actions of certain of the defendants, and failing to avoid conflicts of interest or promptly resolve them. These ERISA claims were predicated upon factual allegations similar to those raised in the derivative and securities class actions described immediately above. The consolidated complaint, as amended, was brought on behalf of a named plaintiff and a putative class consisting of all participants or beneficiaries of the Plans whose accounts included Visteon stock at any time from July 20, 2001 through June 15, 2006. In November 2005, the defendants moved to dismiss the consolidated amended complaint on various grounds. Prior to resolution of the defendants motion, the parties agreed to a settlement. Upon review of the proposed settlement the judge assigned to the proceeding certified a class covering the period July 1, 2000 through July 15, 2006, and preliminarily approved the settlement on December 12, 2006. The court entered an order of final approval of the settlement on March 9, 2007 and

the settlement became effective on April 9, 2007. The amount of the settlement was within the coverage limits of the Company s applicable insurance policy.



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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 19. Commitments and Contingencies (Continued)**

In June 2006, the Company and Ford Motor Company were named as defendants in a purported class action lawsuit brought under ERISA in the United States District Court for the Eastern District of Michigan on behalf of certain former salaried employees of the Company associated with two plants located in Michigan. The complaint alleged that the Company and Ford violated their fiduciary duties under ERISA when they established and spun off the Company and allocated certain pension liabilities between them, and later when they transferred the subject employees to Ford as new hires in 2006 after Ford acquired the plants. In July 2007, the motion to dismiss the complaint filed on behalf of the Company and Ford was granted in part and denied in part.

At this time the Company is not able to predict with certainty the final outcome of each of the foregoing unresolved lawsuits or its potential exposure with respect to each such lawsuit. In the event of an unfavorable resolution of any of these matters, the Company s earnings and cash flows in one or more periods could be materially affected to the extent any such loss is not covered by insurance or applicable reserves.

*Product Warranty and Recall*

Amounts accrued for product warranty and recall claims are based on management s best estimates of the amounts that will ultimately be required to settle such items. The Company s estimates for product warranty and recall obligations are developed with support from its sales, engineering, quality and legal functions and include due consideration of contractual arrangements, past experience, current claims and related information, production changes, industry and regulatory developments and various other considerations. The Company can provide no assurances that it will not experience material claims in the future or that it will not incur significant costs to defend or settle such claims beyond the amounts accrued or beyond what the Company may recover from its suppliers.

The following table provides a reconciliation of changes in product warranty and recall liability for the six-months ended June 30, 2007 and 2006:

| | Product Warranty and Recall | |
|---|---|---|
| | 2007 | 2006 |
| | (Dollars in Millions) | |
| Beginning balance, December 31 | $ 105 | $ 148 |
| Accruals for products shipped | 24 | 22 |
| Changes in estimates | (3) | 2 |
| Settlements | (20) | (13) |
| Ending balance, June 30 | $ 106 | $ 159 |

*Environmental Matters*

The Company is subject to the requirements of federal, state, local and foreign environmental and occupational safety and health laws and regulations. These include laws regulating air emissions, water discharge and waste management. The Company is also subject to environmental laws requiring the investigation and cleanup of environmental contamination at properties it presently owns or operates and at third-party disposal or treatment facilities to which these sites send or arranged to send hazardous waste.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 19. Commitments and Contingencies (Continued)**

The Company is aware of contamination at some of its properties and relating to various third-party superfund sites at which the Company or its predecessor has been named as a potentially responsible party. The Company is in various stages of investigation and cleanup at these sites and at June 30, 2007, had recorded a reserve of approximately $9 million for this environmental investigation and cleanup. However, estimating liabilities for environmental investigation and cleanup is complex and dependent upon a number of factors beyond the Company s control and which may change dramatically. Although the Company believes its reserve is adequate based on current information, the Company cannot provide assurance that the eventual environmental investigation, cleanup costs and related liabilities will not exceed the amount of its current reserve.

*Other Contingent Matters*

In addition to the matters discussed above, various other legal actions, governmental investigations and proceedings and claims are pending or may be instituted or asserted in the future against the Company, including those arising out of alleged defects in the Company s products; governmental regulations relating to safety; employment-related matters; customer, supplier and other contractual relationships; and intellectual property rights. Some of the foregoing matters may involve compensatory, punitive or antitrust or other treble damage claims in very large amounts, or demands for equitable relief, sanctions, or other relief.

Contingencies are subject to many uncertainties, and the outcome of individual litigated matters is not predictable with assurance. Reserves have been established by the Company for matters where losses are deemed probable and reasonably estimable. It is possible, however, that some of the matters could be decided unfavorably to the Company and could require the Company to pay damages or make other expenditures in amounts, or a range of amounts, that cannot be estimated at June 30, 2007 and that are in excess of established reserves. The Company does not reasonably expect, except as otherwise described herein, based on its analysis, that any adverse outcome from such matters would have a material effect on the Company s financial condition, results of operations or cash flows, although such an outcome is possible.

The Company enters into agreements that contain indemnification provisions in the normal course of business for which the risks are considered nominal and impracticable to estimate.

**NOTE 20. Segment Information**

Statement of Financial Accounting Standards No. 131 ( SFAS 131 ), Disclosures about Segments of an Enterprise and Related Information, requires the Company to disclose certain financial and descriptive information about certain segments of its business. Segments are defined as components of an enterprise for which discrete financial information is available that is evaluated regularly by the chief operating decision-maker, or a decision-making group, in deciding the allocation of resources and in assessing performance.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**NOTE 20. Segment Information (Continued)**

The Company s operating structure is comprised of the following: Climate, Electronics, Interiors and Other. These global product groups have financial and operating responsibility over the design, development and manufacture of the Company s product portfolio. Within each of the global product groups, certain facilities manufacture a broader range of the Company s total product line offering and are not limited to the primary product line. Regional customer groups are responsible for the marketing, sales and service of the Company s product portfolio to its customer base. Certain functions such as procurement, information technology and other administrative activities are managed on a global basis with regional deployment. In addition to these global product groups, the Company also operates Visteon Services, a centralized administrative function to monitor and facilitate transactions with ACH for the costs of leased employees and other services provided to ACH by the Company. As a result of the Chassis Divestiture, Visteon Services will also provide transitional administrative support to the buyer for a period of up to eighteen months.

The Company s chief operating decision making group, comprised of the Chief Executive Officer ( CEO ), Chief Operating Officer ( COO ) and Chief Financial Officer ( CFO ), evaluates the performance of the Company s segments primarily based on net sales, before elimination of inter-company shipments, gross margin and operating assets. Gross margin is defined as total sales less costs to manufacture and product development and engineering expenses. Operating assets include inventories and property and equipment utilized in the manufacture of the segments products.

*Overview of Segments*

Climate: The Company s Climate product group includes facilities that primarily manufacture climate air handling modules, powertrain cooling modules, climate controls, heat exchangers, compressors, fluid transport, and engine induction systems.

Electronics: The Company s Electronics product group includes facilities that primarily manufacture audio systems, infotainment systems, driver information systems, powertrain and feature control modules, electronic control modules and lighting.

Interiors: The Company s Interior product group includes facilities that primarily manufacture instrument panels, cockpit modules, door trim and floor consoles.

Other: The Company s Other product group includes facilities that primarily manufacture fuel products, chassis products, powertrain products, alternators and starters, as well as parts sold and distributed to the automotive aftermarket.

Services: The Company s Services operations supply leased personnel and transition services as required by certain agreements entered into by the Company with ACH as a part of the ACH Transactions. Pursuant to the Master Services Agreement and the Salaried Employee Lease Agreement the Company, agreed to provide ACH with certain information technology, personnel and other services to enable ACH to conduct its business. Services to ACH are provided at a rate approximately equal to the Company s cost until such time the services are no longer required by ACH or the expiration of the related agreement. In addition to services provided to ACH, the Company has also agreed to provide certain transition services related to the Chassis Divestiture. The Company expects to provide these services for a period of up to eighteen months.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**NOTE 20. Segment Information (Continued)**

*Net Sales, Gross Margin and Operating Assets*

A summary of net sales and gross margin by segment is provided below:

| | Net Sales | | | | Gross Margin | | | |
|---|---|---|---|---|---|---|---|---|
| | Three-Months Ended June 30 | | Six-Months Ended June 30 | | Three-Months Ended June 30 | | Six-Months Ended June 30 | |
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | | | | | |
| Climate | $ 891 | $ 840 | $ 1,713 | $ 1,640 | $ 53 | $ 66 | $ 93 | $ 120 |
| Electronics | 914 | 911 | 1,786 | 1,792 | 64 | 119 | 126 | 224 |
| Interiors | 813 | 765 | 1,582 | 1,518 | 29 | 28 | 33 | 52 |
| Other | 391 | 468 | 867 | 990 | 10 | 50 | 36 | 91 |
| Eliminations | (176) | (165) | (357) | (355) | | | | |
| Total products | 2,833 | 2,819 | 5,591 | 5,585 | 156 | 263 | 288 | 487 |
| Services | 141 | 138 | 271 | 283 | 1 | 1 | 3 | 2 |
| Total segments | 2,974 | 2,957 | 5,862 | 5,868 | 157 | 264 | 291 | 489 |
| Reconciling Items | | | | | | | | |
| ACH | | | | | | | | |
| Corporate | | | | | (2) | 49 | (19) | 72 |
| Total consolidated | $ 2,974 | $ 2,957 | $ 5,862 | $ 5,868 | $ 155 | $ 313 | $ 272 | $ 561 |

A summary of operating assets by segments is provided below:

| | Inventories | | Property and Equipment, net | |
|---|---|---|---|---|
| | June 30 2007 | December 31 2006 | June 30 2007 | December 31 2006 |
| | (Dollars in Millions) | | | |
| Climate | $ 197 | $ 161 | $ 937 | $ 962 |
| Electronics | 147 | 135 | 749 | 796 |
| Interiors | 64 | 62 | 490 | 478 |

| | | | | |
|---|---|---|---|---|
| Other | 115 | 162 | 105 | 259 |
| Total products | 523 | 520 | 2,281 | 2,495 |
| Reconciling Items | | | | |
| Corporate | | | 509 | 539 |
| Total consolidated | $ 523 | $ 520 | $ 2,790 | $ 3,034 |

*Reconciling Items*

Certain adjustments are necessary to reconcile segment net sales, gross margin, inventories, net and property and equipment, net to the Company s consolidated amounts. Corporate reconciling items are related to the Company s technical centers, corporate headquarters and other administrative and support functions.

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**VISTEON CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 20. Segment Information (Continued)**

*Reclassification*

Segment information for the three and six-months ended June 30, 2006 and as of December 31, 2006 has been reclassified to reflect the alignment of the Company s South American operations with their respective global product groups during the first quarter of 2007.

## ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management s Discussion and Analysis ( MD&A ) is intended to help the reader understand the results of operations, financial condition, and cash flows of Visteon Corporation ( Visteon or the Company ). MD&A is provided as a supplement to, and should be read in conjunction with, the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006 and Current Report on Form 8-K dated August 3, 2007, as filed with the Securities and Exchange Commission and the financial statements and accompanying notes to the financial statements included herein. The financial data presented herein are unaudited, but in the opinion of management reflect those adjustments, including normal recurring adjustments, necessary for a fair presentation of such information.

### Executive Summary

Visteon is a leading global supplier of climate, interiors, electronics and other automotive systems, modules and components to vehicle manufacturers as well as to the automotive aftermarket. The Company sells to all the of the world s largest vehicle manufacturers including BMW, DaimlerChrysler, Ford, General Motors, Honda, Hyundia / Kia, Nissan, Peugot, Renault, Toyota and Volkswagen. The Company has a broad network of manufacturing, technical engineering and joint venture operations throughout the world, supported by approximately 43,000 employees dedicated to the design, development, manufacture and support of its product offering and its global customers. The Company conducts its business across five segments including, Climate, Interiors, Electronics, Other and Services.

By leveraging its extensive experience, innovative technology and geographic strengths, the Company aims to grow leading positions in key climate, interiors and electronics product groups and to improve overall margins, long-term operating profitability and cash flows. To achieve these goals and to respond to industry factors and trends, the Company is working to restructure its business, improve its operations and achieve profitable growth.

Financial results for the three-months ended June 30, 2007 are summarized as follows:

Product sales from continuing operations of $2.83 billion, of which non-Ford customers accounted for 61%

Product gross margin of approximately 5.4%, down from approximately 11.1% for the same period of 2006

Selling, general and administrative expenses of $145 million, $49 million lower than the same period in 2006

Net loss of $67 million or $0.52 per share, compared to net income of $50 million or $0.39 per share for the same period in 2006

Cash of approximately $1.5 billion as of June 30, 2007, $400 million higher than as of December 31, 2006

Cash provided from operating activities of $146 million, compared to cash provided from operating activities of $108 million for the same period in 2006

Capital expenditures of $80 million, lower than the same period in 2006 by $18 million

*Sales and New Business*

Sales from continuing operations were $2.97 billion for the three-months ended June 30, 2007 compared to sales from continuing operations of $2.96 billion for the same period in 2006. Sales from continuing operations for the second quarter of 2007 included favorable foreign currency of $111 million offset by the impact of divestitures, lower North American production volumes, customer pricing and changes in product mix. The Company s sales remain well balanced by core product group with Climate sales of $891 million or 30%, Electronics sales of $914 million or 30% and Interiors sales of $813 million or 27%.

While the distribution of the Company s sales has remained consistent across its core product groups, product sales on a regional basis experienced a significant shift during the three and six months ended June 30, 2007. North American product sales decreased $170 million and $389 million for the three and six

month periods ended June 30, 2007, respectively. The sales decline in North America was primarily driven by decreases in Ford and Nissan vehicle production volumes and past Ford sourcing actions. European product sales increased $26 million and $209 million for the three and six-month periods ended June 30, 2007, respectively. The increases include favorable foreign currency primarily related to the strengthening of the Euro and increased Ford Europe production volumes, partially offset by $96 million of sales from divested chassis facilities. Asia product sales increased by $136 million and $239 million for the three and six-month periods ended June 30, 2007, respectively. The increases are attributable to increased customer production volumes, new business and foreign currency reflecting a strengthened Korean Won.

The automotive industry remains challenging, primarily in North America with continued market share pressures concentrated with U.S. vehicle manufacturers. Continued declines in North American vehicle production from some of the Company s key customers will continue to adversely affect the Company s operating results. However, the Company continues to work with other vehicle manufacturers to further its sales growth and diversification.

The Company continues to win new business maintaining the momentum from 2006 when Visteon won $1 billion of new business. Year-to-date new business wins are approximately $450 million, of which nearly 75 percent is related to business outside of North America and are primarily concentrated in Climate and Electronics product groups. The Company also was awarded significant renewals of existing contracts during 2007 with minimal incumbent losses. Sales from continuing operations for the three-months ended June 30, 2007 included sales to customers other than Ford of $1.7 billion or 61% of total product sales. This represents a significant shift to a more diversified customer base as compared to the same period of 2006 when sales to customers other than Ford were $1.5 billion or 53% of total product sales.

Visteon s customers expect it to continue to reduce the costs of the products it provides, and to increase the level of engineering and related support of vehicle programs on a global basis. The Company must continue to work on reducing its overall costs by restructuring its operations and infrastructure and improving productivity to offset pricing provided to its customers.

*Operations and Restructuring*

The Company s gross margin was $155 million in the second quarter of 2007, compared with $313 million in the second quarter of 2006, representing a decrease of $158 million or 50%. The decrease in gross margin was partially attributable to the non-recurrence of $49 million of OPEB relief in the second quarter of 2006 related to the transfer of certain Visteon salaried employees to Ford in January 2006. Additionally, during the second quarter of 2007 gross margin was affected by a $16 million reduction associated with the European chassis divestiture, $12 million of accelerated depreciation expense related to restructuring activities and $10 million of employee benefit curtailment expense included in cost of sales but reimbursed from the escrow account. The remainder of the gross margin decrease was related to vehicle volume and mix and customer pricing partially offset by improved operating performance.

The Company continues its efforts to improve base operations, which have been focused on quality, safety, investments and cost efficiencies. However, the Company s near term performance has been impacted by lower volumes, unfavorable product mix, premium costs related to certain non-core operations in Europe, and excess costs incurred for several new program launches.

The Company has undertaken various restructuring and other activities to improve base operations and achieve cost efficiencies. Significant actions taken during the three-months ended June 30, 2007 are as follows:

In April 2007, the Company completed the sale of certain chassis operations, including plants in Dueren and Wuelfrath, Germany, and Prazska, Poland, and expects to complete the sale of its related operations located in Sao

Paulo, Brazil by the end of the year.

In May 2007, the Company exited its brake manufacturing operations at its Swansea, Wales, U.K. facility. The exit of the brake manufacturing business allowed for consolidation of facilities at this site which is expected to provide future cost savings.

During the second quarter of 2007, the Company completed the closure of its Chicago, IL and Chesapeake, VA facilities initiated in response to customer sourcing actions.

During the second quarter of 2007 the Company completed negotiations with organized labor representing the workforce at the Company s Connersville, Indiana facility. These negotiations were the result of the Company s decision to close the facility due to of customer sourcing actions.

In June 2007, the Company announced its intention to close its Bedford, Indiana facility as a result of customer sourcing actions.

In connection with facilities and businesses addressed under the multi-year improvement plan, the Company continues to take actions to reduce its overhead costs. Such actions include continued salaried headcount reductions, consolidation of facilities and other overhead cost reductions.

The Company continues to execute its long-term improvement program although no assurances can be provided that the results of these efforts will mitigate the negative industry trends currently being experienced.

*Cash and Liquidity*

Cash provided from operating activities totaled $146 million for the second quarter 2007 increasing $38 million from the same period a year ago driven primarily by trade working capital. Year to date cash provided from operating activities totaled $15 million compared to $76 million for the first six months of 2006. As of June 30, 2007, Visteon had cash balances totaling $1.5 billion and total debt of $2.7 billion. Additionally, no amounts were drawn on the company s $350 million asset-based U.S. revolving credit facility, which had available borrowing capacity of $251 million as of June 30, 2007. The Company also had $233 million available for funding under its $325 million European Securitization facility as of June 30, 2007.

In April 2007, the Company entered into an agreement to amend and restate its existing credit agreement to provide an additional $500 million secured term loan. Consistent with the existing term loan, the additional term loan bears interest at a Eurodollar rate plus 3% and will mature on December 13, 2013. The credit agreement provides for additional collateral and subsidiary guarantors, and allows for an increase in the amount of the additional secured term loan by up to $200 million.

**Results of Operations**

*Discontinued Operations*

In March 2007, the Company entered into a Master Asset and Share Purchase Agreement ( MASPA ) to sell certain assets and liabilities associated with the Company s chassis operations (the Chassis Divestiture ). The Company s chassis operations are primarily comprised of suspension, driveline and steering product lines and include facilities located in Dueren, Germany, Wuelfrath, Germany, Praszka, Poland and Sao Paulo, Brazil. Collectively, these operations recorded sales for the year ended December 31, 2006 of approximately $600 million. The Chassis Divestiture, while representing a significant portion of the Company s chassis operations, did not result in the complete exit of any of the affected product lines.

Effective May 31, 2007, the Company ceased to produce brake components at its Swansea, Wales, U.K. facility, which resulted in the complete exit of the Company s global suspension product line. Accordingly, the results of operations of the Company s global suspension product line have been reclassified to Loss from discontinued operations, net of tax on the consolidated statements of operations for the three and six month periods ended June 30, 2007 and 2006.

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A summary of the results of operations for the global suspension systems product line for the three and six month periods ended June 30, 2007 and 2006 is provided in the table below.

| | Three-Months Ended June 30 | | Six-Months Ended June 30 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in Millions) | | | |
| Net product sales | $ 11 | $ 45 | $ 50 | $ 94 |
| Cost of sales | 18 | 46 | 63 | 100 |
| Gross margin | (7) | (1) | (13) | (6) |
| Selling, general and administrative expenses | | 1 | 1 | 1 |
| Asset impairments | 2 | | 12 | |
| Restructuring expenses | 4 | | 10 | |
| Reimbursement from Escrow Account | 6 | | 12 | |
| Loss from discontinued operations, net of tax | $ 7 | $ 2 | $ 24 | $ 7 |

*Three-Months Ended June 30, 2007 and 2006*

| | Sales | | | Gross Margin | | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | Change | 2007 | 2006 | Change |
| | (Dollars in Millions) | | | | | |
| Climate | $ 891 | $ 840 | $ 51 | $ 53 | $ 66 | $ (13) |
| Electronics | 914 | 911 | 3 | 64 | 119 | (55) |
| Interiors | 813 | 765 | 48 | 29 | 28 | 1 |
| Other | 391 | 468 | (77) | 10 | 50 | (40) |
| Eliminations | (176) | (165) | (11) | | | |
| Total product | 2,833 | 2,819 | 14 | 156 | 263 | (107) |
| Services | 141 | 138 | 3 | 1 | 1 | |
| Total segment | 2,974 | 2,957 | 17 | 157 | 264 | (107) |
| Reconciling Item | | | | | | |
| ACH | | | | | | |
| Corporate | | | | (2) | 49 | (51) |
| Total consolidated | $ 2,974 | $ 2,957 | $ 17 | $ 155 | $ 313 | $ (158) |

*Net Sales*

During the three-months ended June 30, 2007 the Company recorded sales from continuing operations of $2.97 billion, or essentially even when compared to $2.96 billion for the three-months ended June 30, 2006. Included within sales from continuing operations for 2007 is $111 million of favorable currency, the impact of which was partially offset by lower North American production volumes, divestitures, customer pricing and adverse product mix.

Net sales for Climate were $891 million in the three-months ended June 30, 2007 and included favorable currency of $33 million. Climate sales increased by $51 million or 6% when compared with the three-months ended June 30, 2006. In addition to foreign currency, sales increased due to vehicle production volume and mix of $52 million, reflecting growth in Asia from new business and higher Ford Europe vehicle production volumes, partially offset by lower Ford North America vehicle production volumes and lower volumes resulting from past Ford sourcing actions.

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Net sales for Electronics were $914 million in the three-months ended June 30, 2007 compared with $911 million in the three-months ended June 30, 2006. Vehicle production volume and mix was unfavorable by $14 million. Lower Ford North America vehicle production volume and the impact of past sourcing actions reduced net sales by $87 million, which was partially offset by increased sales in Europe of $69 million, primarily related to Ford Europe. Net customer price reductions were more than offset by favorable currency of $40 million.

Net sales for Interiors were $813 million for the three-months ended June 30, of 2007, compared with $765 million for the three-months ended June 30, 2006, representing an increase of $48 million or 6%. Vehicle production volume and mix was favorable $36 million. Increased sales in Asia of $106 million, primarily due to an increase in directed source sales to Hyundai/Kia, was partially offset by lower sales in North America of $73 million, which was driven by lower Ford and Nissan vehicle production. Net customer price reductions were more than offset by favorable currency of $28 million.

The Company s Other product group generated net sales of $391 million during the three-months ended June 30 2007, compared with $468 million in the three-months ended June 30, 2006, representing a decrease of $77 million or 16%. The decrease was primarily due to the second quarter 2007 Chassis Divestiture, which resulted in lower sales of $96 million. Vehicle production volume and mix was unfavorable by $2 million and net customer price reductions were more than offset by favorable currency of $10 million.

Services revenues relate to information technology, engineering, administrative and other business support services provided by the Company under the terms of various agreements. Such services are generally provided at an amount that approximates cost. Total services revenues were $141 million in the three-months ended June 30, 2007, compared with $138 million in the three-months ended June 30, 2006. The increase of $3 million is related to the services provided in connection with the Chassis Divestiture, which commenced in May 2007.

*Gross Margin*

The Company s gross margin was $155 million in the second quarter of 2007, compared with $313 million in the second quarter of 2006, representing a decrease of $158 million or 50%. The decrease in gross margin was attributable to the non-recurrence of $49 million of OPEB relief in the second quarter of 2006 related to the transfer of certain Visteon salaried employees to Ford in connection with Ford s acquisition of two ACH plants located in Rawsonville, MI and Sterling Heights, MI. Additionally, during the second quarter of 2007 gross margin was affected by a $16 million reduction associated with the European chassis divestiture, $10 million of employee benefit curtailment expense included in cost of sales but reimbursed from the escrow account, and $12 million of accelerated depreciation expense related to restructuring activities. The remainder was related to vehicle volume and mix and customer pricing partially offset by improved operating performance.

Gross margin for Climate was $53 million during the three-months ended June 30, 2007, compared with $66 million during the three-months ended June 30, 2006, representing a decrease of $13 million or 20%. The decrease in gross margin resulted from net customer price reductions and increases in raw material costs of $22 million, accelerated depreciation expense related to restructuring activities of $5 million, $16 million of unfavorable vehicle and product mix and lower volumes at the Company s Connersville, Indiana facility which is scheduled to close in the second half of 2007. These decreases were partially offset by $27 million of savings from material and manufacturing cost reduction activities, lower OPEB expenses, and restructuring actions. Gross margin for the second quarter of 2007 also included favorable currency of $3 million.

Gross margin for Electronics was $64 million for the three-months ended June 30, 2007, compared with $119 million for the three-months ended June 30, 2006, representing a decrease of $55 million or 46%. Vehicle production volume and mix was unfavorable $61 million in North America primarily related to lower Ford vehicle production volumes and the impact of past sourcing actions primarily in the audio and powertrain control module product lines. However, vehicle production volume and mix was favorable $22 million in other regions, primarily in Europe reflecting increased Ford Europe vehicle production volume. Material and manufacturing cost reduction activities, lower OPEB expense, and restructuring savings were offset by customer price reductions and increases in raw material costs resulting in a decrease in gross margin of $20 million. Gross margin for the second quarter of 2007 also included favorable currency of $9 million and accelerated depreciation expense related to restructuring activities of $5 million.

Gross margin for Interiors was $29 million in the three-months ended June 30, 2007, compared with $28 million in the three-months ended June 30, 2006. Material and manufacturing cost reduction activities, lower OPEB expense, and restructuring savings improved gross margin by $21 million. These improvements were partially offset by customer price reductions and increases in raw material costs of $14 million, vehicle production volume and mix of $8 million reflecting lower Ford and Nissan vehicle production volumes in North America and the impact of lost volume related to the closure of the Chicago facility and accelerated depreciation expense related to restructuring activities of $1 million. Gross margin for the second quarter of 2007 also included favorable currency of $3 million.

Gross margin for Other was $10 million in the three-months ended June 30, 2007, compared with $50 million in the three-months ended June 30, 2006, representing a decrease of $40 million. This decrease includes, $10 million of pension curtailment expense included in cost of sales in 2007 but reimbursed from the escrow account, a $16 million decrease due to the divestiture of the Company s European chassis operations and $1 million of unfavorable currency. Additionally, vehicle production volume and mix of $15 million and customer price reductions and increases in raw material costs of $13 million were partially offset by lower OPEB expense, material and manufacturing cost reduction activities, and restructuring savings of $15 million.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses of $145 million for the three-months ended June 30, 2007 decreased by $49 million or 25% when compared with $194 million for the same period of 2006. The decrease primarily resulted from $24 million of cost efficiencies related to salaried headcount reductions during the fourth quarter of 2006 and the first quarter of 2007, lower stock-based compensation expense of $16 million and a reduction of $3 million related to the Chassis Divestiture.

*Asset Impairments*

The Company recorded asset impairment charges of $11 million during the three month period ended June 30, 2007. These impairment charges included $8 million related to assets subject to the Chassis Divestiture including inventory, intellectual property, and real and personal property that met the held for sale criteria of SFAS 144. The Company recorded an additional $3 million of impairment charges to adjust the carrying value of the related assets held for sale to the lower of carrying amount or fair value less cost to sell related to restructuring activities undertaken at a North American Other facility.

*Restructuring Expenses*

During the second quarter of 2007 the Company recorded restructuring charges of $37 million under the previously announced multi-year improvement plan. Such costs are fully reimbursable under the terms of the Escrow Agreement. Significant restructuring actions for the three-months ended June 30, 2007 include the following.

The Company recorded $10 million of employee severance and termination benefit costs for approximately 150 employees at a European Interiors facility related to the planned transfer of production to other facilities.

Approximately $8 million of employee severance and termination benefit costs were recorded for approximately 40 hourly and 20 salaried employees at various European facilities.

The Company recorded $7 million related to the previously announced closure of a North American Climate facility. Of this additional amount, $6 million relates to employee severance and termination benefits and the remaining $1 million is for lease termination costs.

The Company continues to evaluate its general and administrative support structure and continues to reduce such costs as related to restructuring actions taken under the multi-year improvement plan. As a result, $6 million of employee severance and termination benefit costs related to approximately 55 salaried employee reductions were recorded.

The Company recorded an estimate of employee severance and termination benefit costs of approximately $4 million for the probable payment of such post-employment benefit costs in connection with the multi-year improvement plan.

*Interest*

Interest expense was $55 million for the three-months ended June 30, 2007 as compared to $53 million for the same period of 2006. The increase of $2 million was due to higher average debt levels in 2007. Interest income increased by $7 million to a total of $14 million for the three-months ended June 30, 2007 largely due to higher cash balances and related investments in 2007.

*Income Taxes*

The provision for income taxes of $28 million for the three-month period ended June 30, 2007 represents an increase of $11 million when compared with $17 million in the same period of 2006. The income tax provisions for the three-month periods ended June 30, 2007 and 2006 reflect income tax expense related to those countries where the Company is profitable, accrued withholding taxes, certain non-recurring and other discrete items and the inability to record a tax benefit for pre-tax losses in the U.S. and certain foreign countries to the extent not offset by other categories of income in those jurisdictions.

In the second quarter of 2007, net pre-tax other comprehensive income arising from re-measurement of pension and OPEB obligations in the U.S. and Germany effectively offset $54 million of second quarter pre-tax operating losses in the U.S. and Germany. Accordingly, the Company s current period valuation allowance was reduced resulting in a benefit of $19 million allocated to the current year loss from continuing operations. The provision for income taxes for the three-month period ended June 30, 2007 also includes an expense of $17 million reflecting an increase in unrecognized tax benefits as a result of certain positions taken in tax returns filed in the quarter, as well as those expected to be taken in future tax returns. Non-recurring and other discrete items recorded in the three-month period ended June 30, 2006 included a $14 million benefit to restore net deferred tax assets associated with the Company s

operations in Brazil.

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*Six-Months Ended June 30, 2007 and 2006*

| | Net Sales | | | Gross Margin | | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | Change | 2007 | 2006 | Change |
| | | | (Dollars in Millions) | | | |
| Climate | $ 1,713 | $ 1,640 | $ 73 | $ 93 | $ 120 | $ (27) |
| Electronics | 1,786 | 1,792 | (6) | 126 | 224 | (98) |
| Interiors | 1,582 | 1,518 | 64 | 33 | 52 | (19) |
| Other | 867 | 990 | (123) | 36 | 91 | (55) |
| Eliminations | (357) | (355) | (2) | | | |
| Total products | 5,591 | 5,585 | 6 | 288 | 487 | (199) |
| Services | 271 | 283 | (12) | 3 | 2 | 1 |
| Total segments | 5,862 | 5,868 | (6) | 291 | 489 | (198) |
| Reconciling Items | | | | | | |
| ACH | | | | | | |
| Corporate | | | | (19) | 72 | (91) |
| Total consolidated | $ 5,862 | $ 5,868 | $ (6) | $ 272 | $ 561 | $ (289) |

*Net Sales*

Net sales from continuing operations were $5.86 billion for the six-months ended June 30, 2007, essentially even when compared with $5.87 billion for the same period of 2006. Sales from continuing operations for the six-months ended June 30, 2007 increased by $298 million due to favorable foreign currency, higher volumes in Europe related to Ford and PSA, an increase in directed source parts in Asia and net new business. These increases were largely offset by lower Ford and Nissan vehicle production volumes in North America, the impact of past Ford sourcing actions, the divestiture of the Company s European chassis operations of $96 million and customer price reductions.

Net sales for Climate were $1.7 billion in the six-months ended June 30, 2007, compared with $1.6 billion in the six-months ended June 30, 2006, representing an increase of $73 million or 4%. Continued growth in Asia increased sales by $76 million principally attributable to new business and higher production volumes. New business launched at a North American manufacturing facility offset by lower Ford North America vehicle production and unfavorable product mix reduced sales in North America by $73 million. Higher sales in Europe principally related to Ford vehicle production volumes increased sales $51 million. Net customer price reductions were more than offset by favorable currency of $81 million.

Net sales for Electronics were $1.8 billion for each of the six-month periods ended June 30, 2007 and 2006. Sales decreased in North America by $169 million related to lower Ford vehicle production volumes and adverse product mix partially offset by higher sales in Europe of $116 million reflecting higher Ford vehicle production volumes. Net customer price reductions were more than offset by favorable currency of $93 million.

Net sales for Interiors were $1.6 billion in the six-months ended June 30, 2007, compared with $1.5 billion in the six-months ended June 30, 2006, representing an increase of $64 million or 4%. Vehicle production volume and product mix was favorable $6 million. Increased sales in Asia of $184 million, primarily due to an increase in directed

source content for Hyundai/Kia production, was partially offset by lower sales in North America of $169 million, primarily due to lower Ford and Nissan vehicle production as well as the impact of lost volume related to the closure of the Chicago facility. Net customer price reductions were more than offset by favorable currency of $83 million.

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Net sales for Other were $867 million in the six-months ended June 30, 2007, compared with $1.0 billion in the six-months ended June 30, 2006, representing a decrease of $123 million or 12%. The decrease is largely attributable to the divestiture of the Company s European chassis operations, which resulted in a decrease of $96 million. Sales decreased by $63 with reductions in all regions related to lower vehicle production volumes and adverse product mix. Net customer price reductions were more than offset by favorable currency of $41 million.

Services revenues relate to information technology, engineering, administrative and other business support services provided by the Company under the terms of various agreements. Such services are generally provided at an amount that approximates cost. Services revenues were $271 million in the six-month period ended June 30, 2007 compared with $283 million in the six-month period ended June 30, 2006.

*Gross Margin*

The Company s gross margin was $272 million in the six-months ended June 30, 2007, compared with $561 million in the six-months ended June 30, 2006, representing a decrease of $289 million or 52%. The decrease in gross margin was partially attributable to the non-recurrence of $72 million of OPEB relief from the six-months ended June 30, 2006 related to the transfer of certain Visteon salaried employees to Ford. Additionally, during 2007 gross margin was affected by $20 million of employee benefit curtailment expense included in cost of sales but reimbursed from the escrow account, $22 million of accelerated depreciation expense related to restructuring activities, a $16 million reduction associated with the European chassis divestiture, and $9 million in net OPEB and pension settlements. The remainder was related to vehicle production volume and mix and customer pricing partially offset by improved operating performance.

Gross margin for Climate was $93 million in the six-months ended June 30, 2007, compared with $120 million in the six-months ended June 30, 2006, representing a decrease of $27 million or 23%. Although net sales increased during the period, unfavorable vehicle and product mix as well as lower vehicle production volumes related to restructuring activities primarily at the Company s Connersville, Indiana facility resulted in a decrease in gross margin of $34 million. Material and manufacturing cost reduction activities, lower OPEB expenses and restructuring savings improved gross margin $38 million and favorable foreign currency resulted in an additional $3 million improvement. This performance was partially offset by net customer price reductions, increases in raw material costs of $25 million and accelerated depreciation expense related to restructuring activities of $9 million.

Gross margin for Electronics was $126 million in the six-months ended June 30, 2007, compared with $224 million in the six-months ended June 30, 2006, representing a decrease of $98 million or 44%. Vehicle production volume and mix was unfavorable $109 million in North America primarily related to lower Ford vehicle production volumes and the impact of past sourcing actions primarily in the audio and powertrain control module product lines. However, vehicle production volume and mix was favorable $38 million in other regions, primarily in Europe reflecting increased Ford Europe vehicle production volume. Material and manufacturing cost reduction activities, lower OPEB expense, and restructuring savings improved gross margin $12 million, and favorable currency also improved gross margin $10 million. This performance was offset by customer price reductions and increases in raw material costs resulting in a decrease in gross margin of $41 million and accelerated depreciation expense related to restructuring activities of $8 million.

Gross margin for Interiors was $33 million in the six-months ended June 30, 2007, compared with $52 million in the six-months ended June 30, 2006, representing a decrease of $19 million or 37%. Vehicle production volume and mix was unfavorable $8 million reflecting lower Ford and Nissan vehicle production volumes in North America and the impact of lost volume related to the closure of the Chicago facility. Material and manufacturing cost reduction activities, lower OPEB expense, and restructuring savings improved gross margin $11 million and favorable foreign currency improved gross margin $4 million. This performance was partially offset by customer price reductions and increases in raw material costs resulting in a decrease in gross margin of $22 million and accelerated depreciation expense related to restructuring activities of $4 million.

Gross margin for Other was $36 million in the six-months ended June 30, 2007, compared with $91 million in the six-months ended June 30, 2006, representing a decrease of $55 million or 60%. This decrease includes a $20 million pension curtailment expense included in cost of sales in 2007 but reimbursed from the escrow account. Additionally, the divestiture of the European chassis operations resulted in a $16 million reduction to gross margin. Vehicle production volume and mix was unfavorable $17 million. Lower OPEB expense, material and manufacturing cost reduction activities, and restructuring savings improved gross margin $23 million. Customer price reductions and increases in raw material costs decreased gross margin $24 million, and currency decreased gross margin by $1 million.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses of $314 million for the six-months ended June 30, 2007 decreased by $47 million or 13% when compared with $361 million for the same period of 2006. The decrease resulted from $31 million of cost efficiencies related to salaried headcount reductions during the fourth quarter of 2006 and the first quarter of 2007, lower stock-based compensation expense of $22 million, and a reduction of $3 million related to the Chassis Divestiture, which were partially offset by $9 million of unfavorable currency.

*Asset Impairments*

The Company recorded asset impairment charges of $51 million during the six-month period ended June 30, 2007. These impairment charges were recorded to adjust the carrying value of associated long-lived assets to their estimated fair value in accordance with SFAS 144.

During the first quarter of 2007, the Company determined that assets subject to the Chassis Divestiture including inventory, intellectual property, and real and personal property met the held for sale criteria of SFAS 144. Accordingly, these assets are valued at the lower of carrying amount or fair value less cost to sell, which resulted in asset impairment charges of approximately $25 million through the first six months of 2007.

In consideration of the MASPA and the Company s announced exit of the brake manufacturing business at its chassis facility located in Swansea, Wales, U.K., an asset impairment charge of $16 million was recorded to reduce the net book value of certain long-lived assets at the facility to their estimated fair value in the first quarter. The Company s estimate of fair value was based on market prices, prices of similar assets, and other available information.

During the first quarter of 2007, the Company entered into an agreement to sell an Electronics building located in Hiroshima, Japan. The Company determined that this building met the held for sale criteria of SFAS 144 as of March 31, 2007 and was recorded at the lower of carrying value or fair value less cost to sell, which resulted in an asset impairment charge of approximately $7 million.

In connection with restructuring activities undertaken at a North American Other facility, the Company recorded an asset impairment of $3 million to reduce the net book value of certain long-lived assets to their estimated fair value

during the three-months ended June 30, 2007.

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*Restructuring Expenses*

During the first six months of 2007 the Company recorded restructuring charges of $62 million under the previously announced multi-year improvement plan. Such costs are fully reimbursable under the terms of the Escrow Agreement. Significant restructuring actions for the six-months ended June 30, 2007 include the following.

The Company recorded an estimate of employee severance and termination benefit costs of approximately $22 million for the probable payment of such post-employment benefit costs in connection with the multi-year improvement plan.

The Company recorded $10 million of employee severance and termination benefit costs for approximately 150 employees at a European Interiors facility related to the transfer of production to other facilities.

The Company recorded $10 million of employee severance and termination benefit costs related to the elimination of approximately 150 salaried positions.

Approximately $8 million of employee severance and termination benefit costs were recorded for approximately 40 hourly and 20 salaried employees at various European facilities.

Approximately $7 million was recorded related to the closure of a North American Climate facility related to employee severance and termination benefits and lease termination costs.

*Interest*

Interest expense was $104 million for the six-months ended June 30, 2007 as compared to $100 million for the same period of 2006. The increase of $4 million was due to higher average debt levels in 2007. Interest income increased by $8 million to a total of $23 million for the six-months ended June 30, 2007 largely due to higher cash balances and related investments in 2007.

*Income Taxes*

The provision for income taxes of $45 million for the six-month period ended June 30, 2007 represents a decrease of $2 million when compared with $47 million in the same period of 2006. The income tax provisions for the six-month periods ended June 30, 2007 and 2006 reflect income tax expense related to those countries where the Company is profitable, accrued withholding taxes, certain non-recurring and other discrete items and the inability to record a tax benefit for pre-tax losses in the U.S. and certain foreign countries to the extent not offset by other categories of income in those jurisdictions.

In the first six months of 2007, net pre-tax other comprehensive income primarily attributable to the re-measurement of pension and OPEB obligations in the U.S. and Germany, effectively offset approximately $77 million of pre-tax operating losses in the U.S. and Germany. Accordingly, the Company s current period valuation allowance was reduced resulting in a benefit of $27 million allocated to the current year loss from continuing operations. The provision for income taxes for the six-month period ended June 30, 2007 also includes an expense of $15 million reflecting an increase in unrecognized tax benefits as a result of certain positions taken in tax returns filed in the second quarter, as well as those expected to be taken in future tax returns. Non-recurring and other discrete items recorded in the six-month period ended June 30, 2006 included a $14 million benefit to restore net deferred tax assets associated with the Company s operations in Brazil.

**Liquidity**

*Overview*

The Company s cash and liquidity needs are impacted by the level, variability, and timing of its customers worldwide vehicle production, which varies based on economic conditions and market shares in major

markets. The Company s intra-year needs are impacted by seasonal effects in the industry, such as the shutdown of operations for two weeks in July, the subsequent ramp-up of new model production and the additional one-week shutdown in December by its primary North American customers. These seasonal effects normally require use of liquidity resources during the first and third quarters.

The Company believes that cash generated from operations and its available borrowing capacity under current agreements will be adequate to fund working capital requirements, restructuring activities, capital expenditures, debt service requirements and technology investments. However, the Company s ability to continue to fund these items may be adversely affected by many factors including, but not limited to, general economic conditions, specific industry conditions, financial markets, competitive factors and legislative and regulatory changes. Therefore, assurance cannot be provided that Visteon will generate sufficient cash flow from operations or that available borrowings will be sufficient to enable the Company to meet its liquidity needs.

*Credit Ratings*

Moody s current corporate rating of the company is B3 and SGL rating is 3. The rating on senior unsecured debt is Caa2 with a negative outlook. The current corporate rating of the Company by S&P is B and the short term liquidity rating is B-3, with a negative outlook on the rating. Fitch s current rating on the Company s senior secured debt is B with a negative outlook.

Any further downgrade in the Company s credit ratings could reduce its access to capital, increase the costs of future borrowings, and increase the possibility of more restrictive terms and conditions contained in any new or replacement financing arrangements or commercial agreements or payment terms with suppliers.

*Cash and Equivalents*

As of June 30, 2007 and December 31, 2006, the Company s consolidated cash balances totaled $1.5 billion and $1.1 billion, respectively. As the Company s operating profitability has become more concentrated with its foreign subsidiaries and joint ventures, the Company s cash balances located outside the U.S. continue to be significant. The Company s ability to efficiently access cash balances in certain foreign jurisdictions is subject to local regulatory and statutory requirements.

*Asset Securitization*

The Company transfers certain customer trade account receivables originating from subsidiaries located in Germany, Portugal, Spain, France and the U.K. ( Sellers ) pursuant to a European securitization agreement ( European Securitization ). The European Securitization agreement extends until August 2011 and provides up to $325 million in funding from the sale of receivables originated by the Sellers and transferred to Visteon Financial Centre P.L.C. (the Transferor ). The Transferor is a bankruptcy-remote qualifying special purpose entity. Receivables transferred from the Sellers are funded through cash obtained from the issuance of variable loan notes to third-party lenders and through subordinated loans obtained from a wholly-owned subsidiary of the Company, which represent the Company s retained interest in the receivables transferred.

Availability of funding under the European Securitization depends primarily upon the amount of trade account receivables, reduced by outstanding borrowings under the program and other characteristics of those receivables that affect their eligibility (such as bankruptcy or the grade of the obligor, delinquency and excessive concentration). As of June 30, 2007, approximately $325 million of the Company s transferred receivables were considered eligible for borrowing under this facility, $92 million was outstanding and $233 million was available for funding.

*Revolving Credit*

The Company s Revolving Credit Agreement allows for available borrowings of up to $350 million. The amount of availability at any time is dependent upon various factors, including outstanding letters of credit, the amount of eligible receivables, inventory and property and equipment. Borrowings under the Revolving Credit Agreement bear interest based on a variable rate interest option selected at the time of borrowing. The Revolving Credit Agreement expires on August 14, 2011.

As of June 30, 2007, there were no outstanding borrowings under the Revolving Credit Agreement. The Company had $251 million of available borrowings under the facility after a reduction for $99 million of obligations under letters of credit at June 30, 2007.

Obligations under the Revolving Credit Agreement are collateralized by a first-priority lien on certain assets of the Company and most of its domestic subsidiaries, including real property, accounts receivable, inventory, equipment and other tangible and intangible property, including the capital stock of nearly all direct and indirect domestic subsidiaries (other than those domestic subsidiaries the sole assets of which are capital stock of foreign subsidiaries), as well as a second-priority lien on substantially all other material tangible and intangible assets of the Company and most of its domestic subsidiaries which collateralize the Company s seven-year term loan agreement. The terms of the Revolving Credit Agreement limit the obligations collateralized by certain U.S. assets to ensure compliance with the Company s bond indenture.

**Cash Flows**

*Operating Activities*

Cash provided from operating activities was $15 million during the six-months ended June 30, 2007, compared with $76 million for the same period in 2006. The decrease is largely attributable to a higher net loss, as adjusted for non-cash items, an increase in Ford North American receivable terms from 22 days to 26 days, and incentive compensation payments in 2007, partially offset by the non-recurrence of the settlement of outstanding payable balances with ACH plants in 2006 and improved working capital.

*Investing Activities*

Cash used by investing activities was $55 million during the six-months ended June 30, 2007, compared with $172 million for the same period in 2006. The decrease in cash usage resulted principally from the proceeds from the sale of the chassis operations in 2007, as well as a reduction in capital expenditures, excluding capital leases. The Company s capital expenditures, excluding capital leases, in the six-months ended June 30, 2007 totaled $144 million, compared with $183 million for the same period in 2006.

*Financing Activities*

Cash provided from financing activities totaled $444 million in the six-months ended June 30, 2007, compared with $43 million for the same period in 2006. The cash proceeds in 2007 reflect the proceeds from the Company s $500 million addition to its seven-year term loan, partially offset by reductions in affiliate debt and book overdrafts. Cash provided from financing activities increased by $401 million when compared to the six-months ended June 30, 2006, which included proceeds from the Company s $800 million seven-year term loan, partially offset by repayment of $347 million on the Company s revolving credit facility, repayment and termination of the Company s $241 million five-year term loan, and repurchase of $150 million of its outstanding 8.25% interest bearing notes due August 1, 2010.

**Other Debt and Capital Structure**

Additional information related to the Company s other debt and related agreements is set forth in Note 14 Debt , to the consolidated financial statements included herein under Item 1.

*Covenants and Restrictions of Credit Agreements*

Subject to limited exceptions, each of the Company s direct and indirect, existing and future, domestic subsidiaries as well as certain foreign subsidiaries, acts as guarantor under its $1.5 billion term loan credit agreement. The obligations under the credit agreement are secured by a first-priority lien on certain assets of the Company and most of its domestic subsidiaries, including intellectual property, intercompany debt, the capital stock of nearly all direct and indirect domestic subsidiaries as well as certain foreign subsidiaries, and 65% of the stock of certain foreign subsidiaries, as well as a second-priority lien on substantially all other material tangible and intangible assets of the Company and most of its domestic subsidiaries.

The obligations under the revolving credit agreement are secured by a first-priority lien on certain assets of the Company and most of its domestic subsidiaries, including real property, accounts receivable, inventory, equipment and other tangible and intangible property, including the capital stock of nearly all direct and indirect domestic subsidiaries (other than those domestic subsidiaries the sole assets of which are capital stock of foreign subsidiaries) and certain foreign subsidiaries, as well as a second-priority lien on substantially all other material tangible and intangible assets of the Company and most of its domestic subsidiaries which secure the Company s term loan credit agreement.

The terms relating to both credit agreements specifically limit the obligations to be secured by a security interest in certain U.S. manufacturing properties and intercompany indebtedness and capital stock of U.S. manufacturing subsidiaries in order to ensure that, at the time of any borrowing under the Credit Agreement and other credit lines, the amount of the applicable borrowing which is secured by such assets (together with other borrowings which are secured by such assets and obligations in respect of certain sale-leaseback transactions) do not exceed 15% of Consolidated Net Tangible Assets (as defined in the indenture applicable to the Company s outstanding bonds and debentures).

The credit agreements contain, among other things, mandatory prepayment provisions for certain asset sales, recovery events, equity issuances and debt incurrence, covenants, representations and warranties and events of default customary for facilities of this type. Such covenants include certain restrictions on the incurrence of additional indebtedness, liens, acquisitions and other investments, mergers, consolidations, liquidations and dissolutions, sales of assets, dividends and other repurchases in respect of capital stock, voluntary prepayments of certain other indebtedness, capital expenditures, transactions with affiliates, changes in fiscal periods, hedging arrangements, lines of business, negative pledge clauses, subsidiary distributions and the activities of certain holding company subsidiaries, subject to certain exceptions.

Under certain conditions, amounts outstanding under the credit agreements may be accelerated. Bankruptcy and insolvency events with respect to us or certain of our subsidiaries will result in an automatic acceleration of the indebtedness under the credit agreements. Subject to notice and cure periods in certain cases, other events of default under the credit agreements will result in acceleration of indebtedness under the credit agreements at the option of the lenders. Such other events of default include failure to pay any principal, interest or other amounts when due, failure to comply with covenants, breach of representations or warranties in any material respect, non-payment or acceleration of other material debt, entry of material judgments not covered by insurance, or a change of control of the Company.

At June 30, 2007, the Company was in compliance with applicable covenants and restrictions, as amended, although there can be no assurance that the Company will remain in compliance with such covenants in the future. If the Company was to violate a covenant and not obtain a waiver, the credit agreements could be terminated and amounts outstanding would be accelerated. The Company can provide no assurance that, in such event, it would have access to sufficient liquidity resources to repay such amounts.

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**Off-Balance Sheet Arrangements**

*Guarantees*

The Company has guaranteed certain Tier 2 suppliers debt and lease obligations and other third-party service providers obligations to ensure the continued supply of essential parts. These guarantees have not, nor does the Company expect they are reasonably likely to have, a material current or future effect on the Company s financial position, results of operations or cash flows.

*Asset Securitization*

Transfers under the European Securitization, for which the Company receives consideration other than a beneficial interest, are accounted for as true sales under the provisions of Statement of Financial Accounting Standards No. 140 ( SFAS 140 ), Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities and are removed from the balance sheet. Transfers under the European Securitization, for which the Company receives a beneficial interest are not removed from the balance sheet and total $551 million and $482 million as of June 30, 2007 and December 31, 2006, respectively. Such amounts are recorded at fair value and are subordinated to the interests of the third-party lenders. Securities representing the Company s retained interests are accounted for as trading securities under Statement of Financial Accounting Standards No. 115 Accounting for Certain Investments in Debt and Equity Securities.

Availability of funding under the European Securitization depends primarily upon the amount of trade account receivables, reduced by outstanding borrowings under the program and other characteristics of those receivables that affect their eligibility (such as bankruptcy or the grade of the obligor, delinquency and excessive concentration). As of June 30, 2007, approximately $325 million of the Company s transferred receivables were considered eligible for borrowing under this facility, $92 million was outstanding and $233 million was available for funding. The Company recorded losses of $3 million and $4 million for the three and six-month periods ended June 30, 2007 related to receivables sold under the European Securitization.

The table below provides a reconciliation of the change in interests in account receivables transferred for the period.

| | Three-Months Ended June 30, 2007 | Six-Months Ended June 30, 2007 |
|---|---|---|
| | (Dollars in Millions) | |
| Beginning balance | $ 574 | $ 482 |
| Receivables transferred | 865 | 1,889 |
| Proceeds from new securitizations | | (41) |
| Proceeds from collections reinvested in securitization | (116) | (257) |
| Cash flows received on interests received | (772) | (1,522) |
| Ending balance | $ 551 | $ 551 |

**New Accounting Standards**

In February 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 159 ( SFAS 159 ), The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. SFAS 159 permits measurement of financial instruments and certain other items at fair value. SFAS 159 is designed to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective as of the beginning of the first fiscal year after November 15, 2007. The Company is currently evaluating the impact of this statement on its consolidated financial statements.

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In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements. This statement, which becomes effective January 1, 2008, defines fair value, establishes a framework for measuring fair value and expands disclosure requirements regarding fair value measurements. The Company is currently evaluating the impact of this statement on its consolidated financial statements.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156 ( SFAS 156 ), Accounting for Servicing of Financial Assets. This statement amends Statement of Financial Accounting Standards No. 140, ( SFAS 140 ), Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Company adopted SFAS 156 as of January 1, 2007 without a material impact on its consolidated financial statements.

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155 ( SFAS 155 ), Accounting for Certain Hybrid Financial Instruments which amends Statement of Financial Accounting Standards No. 133 ( SFAS 133 ), Accounting for Derivatives Instruments and Hedging Activities and SFAS 140. SFAS 155 amends SFAS 133 to narrow the scope exception for interest-only and principal only strips on debt instruments to include only such strips representing rights to receive a specified portion of the contractual interest or principle cash flows. The Company adopted SFAS 155 as of January 1, 2007 without a material impact on its consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in accordance with Statement of Financial Accounting Standards No. 109 ( SFAS 109 ) Accounting for Income Taxes and prescribes a recognition threshold and measurement process for recording in the financial statements tax positions taken or expected to be taken in a tax return. The evaluation of a tax position under FIN 48 is a two-step process. The first step requires an entity to determine whether it is more likely than not that a tax position will be sustained upon examination based on the technical merits of the position. For those positions that meet the more likely than not recognition threshold, the second step requires measurement of the largest amount of benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. The Company adopted the provisions of FIN 48 effective January 1, 2007, without a material impact to the Company s consolidated financial statements.

**Cautionary Statements Regarding Forward-Looking Information**

Certain statements contained or incorporated in this Interim Report on Form 10-Q which are not statements of historical fact constitute Forward-Looking Statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Reform Act ). Forward-looking statements give current expectations or forecasts of future events. Words such as anticipate , expect , intend , plan , believe , seek , estimate and other words and terms of simila connection with discussions of future operating or financial performance signify forward-looking statements. These statements reflect the Company s current views with respect to future events and are based on assumptions and estimates, which are subject to risks and uncertainties including those discussed in Item 1A under the heading Risk Factors in the Company s Annual Report on Form 10-K for fiscal year 2006 and elsewhere in this report. Accordingly, the reader should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent the Company s estimates and assumptions only as of the date of this report. The Company does not intend to update any of these forward-looking statements to reflect circumstances or events that occur after the statement is made. The Company qualifies all of its forward-looking statements by these cautionary statements.

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The reader should understand that various factors, in addition to those discussed elsewhere in this document, could affect the Company s future results and could cause results to differ materially from those expressed in such forward-looking statements, including:

Visteon s ability to satisfy its future capital and liquidity requirements; Visteon s ability to access the credit and capital markets at the times and in the amounts needed and on terms acceptable to Visteon, which is influenced by Visteon s credit ratings (which have declined in the past and could decline further in the future); Visteon s ability to comply with covenants applicable to it; and the continuation of acceptable supplier payment terms.

Visteon s ability to satisfy its pension and other postemployment benefit obligations, and to retire outstanding debt and satisfy other contractual commitments, all at the levels and times planned by management.

Visteon s ability to access funds generated by its foreign subsidiaries and joint ventures on a timely and cost effective basis.

Changes in the operations (including products, product planning and part sourcing), financial condition, results of operations or market share of Visteon s customers, particularly its largest customer, Ford.

Changes in vehicle production volume of Visteon s customers in the markets where we operate, and in particular changes in Ford s North American and European vehicle production volumes and platform mix.

Visteon s ability to profitably win new business from customers other than Ford and to maintain current business with, and win future business from, Ford, and, Visteon s ability to realize expected sales and profits from new business.

Increases in commodity costs or disruptions in the supply of commodities, including steel, resins, aluminum, copper, fuel and natural gas.

Visteon s ability to generate cost savings to offset or exceed agreed upon price reductions or price reductions to win additional business and, in general, improve its operating performance; to achieve the benefits of its restructuring actions; and to recover engineering and tooling costs.

Visteon s ability to compete favorably with automotive parts suppliers with lower cost structures and greater ability to rationalize operations; and to exit non-performing businesses on satisfactory terms, particularly due to limited flexibility under existing labor agreements.

Restrictions in labor contracts with unions that restrict Visteon s ability to close plants, divest unprofitable, noncompetitive businesses, change local work rules and practices at a number of facilities and implement cost-saving measures.

The costs and timing of facility closures or dispositions, business or product realignments, or similar restructuring actions, including potential impairment or other charges related to the implementation of these actions or other adverse industry conditions and contingent liabilities.

Significant changes in the competitive environment in the major markets where Visteon procures materials, components or supplies or where its products are manufactured, distributed or sold.

Legal and administrative proceedings, investigations and claims, including shareholder class actions, SEC inquiries, product liability, warranty, environmental and safety claims, and any recalls of products manufactured or sold by

Visteon.

Changes in economic conditions, currency exchange rates, changes in foreign laws, regulations or trade policies or political stability in foreign countries where Visteon procures materials, components or supplies or where its products are manufactured, distributed or sold.

Shortages of materials or interruptions in transportation systems, labor strikes, work stoppages or other interruptions to or difficulties in the employment of labor in the major markets where Visteon purchases materials, components or supplies to manufacture its products or where its products are manufactured, distributed or sold.

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Changes in laws, regulations, policies or other activities of governments, agencies and similar organizations, domestic and foreign, that may tax or otherwise increase the cost of, or otherwise affect, the manufacture, licensing, distribution, sale, ownership or use of Visteon s products or assets.

Possible terrorist attacks or acts of war, which could exacerbate other risks such as slowed vehicle production, interruptions in the transportation system, or fuel prices and supply.

The cyclical and seasonal nature of the automotive industry.

Visteon s ability to comply with environmental, safety and other regulations applicable to it and any increase in the requirements, responsibilities and associated expenses and expenditures of these regulations.

Visteon s ability to protect its intellectual property rights, and to respond to changes in technology and technological risks and to claims by others that Visteon infringes their intellectual property rights.

Visteon s ability to provide various employee and transition services to Automotive Components Holdings, LLC in accordance with the terms of existing agreements between the parties, as well as Visteon s ability to recover the costs of such services.

The availability of Visteon s federal net operating loss carryforward and other federal income tax attributes may be eliminated or significantly limited if a change of ownership of Visteon, within the meaning of Section 382 of the Internal Revenue Code, were to occur.

Visteon s ability to quickly and adequately remediate control deficiencies in its internal control over financial reporting.

Other factors, risks and uncertainties detailed from time to time in Visteon s Securities and Exchange Commission filings.

**Other Financial Information**

PricewaterhouseCoopers LLP, an independent registered public accounting firm, performed a limited review of the financial data presented on page 3 through 29 inclusive. The review was performed in accordance with standards for such reviews established by the Public Company Accounting Oversight Board (United States). The review did not constitute an audit; accordingly, PricewaterhouseCoopers LLP did not express an opinion on the aforementioned data. Their review report included herein is not a report within the meaning of Sections 7 and 11 of the Securities Act of 1933 and the independent registered public accounting firm s liability under Section 11 does not extend to it.

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## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risks from changes in currency exchange rates, interest rates and certain commodity prices. To manage these risks, the Company uses a combination of fixed price contracts with suppliers, cost sourcing arrangements with customers and financial derivatives. The Company maintains risk management controls to monitor the risks and the related hedging. Derivative positions are examined using analytical techniques such as market value and sensitivity analysis. Derivative instruments are not used for speculative purposes, as per clearly defined risk management policies.

*Foreign Currency Risk*

The Company s net cash inflows and outflows exposed to the risk of changes in exchange rates arise from the sale of products in countries other than the manufacturing source, foreign currency denominated supplier payments, debt and other payables, subsidiary dividends and investments in subsidiaries. The Company s on-going solution is to reduce the exposure through operating actions.

The Company s primary foreign exchange operating exposures include the Euro, Korean Won, Czech Koruna and Mexican Peso. Because of the mix between the Company s costs and revenues in various regions, operating results are exposed generally to weakening of the Euro and to strengthening of the Korean Won, Czech Koruna and Mexican Peso. For transactions in these currencies, the Company utilizes a strategy of partial coverage. As of June 30, 2007, the Company s coverage for projected transactions in these currencies was approximately 70% for 2007.

As of June 30, 2007 and December 31, 2006, the net fair value of foreign currency forward and option contracts was an asset of $1 million and $8 million, respectively. The hypothetical pre-tax gain or loss in fair value from a 10% favorable or adverse change in quoted currency exchange rates would be approximately $58 million and $76 million as of June 30, 2007 and December 31, 2006, respectively. These estimated changes assume a parallel shift in all currency exchange rates and include the gain or loss on financial instruments used to hedge loans to subsidiaries. Because exchange rates typically do not all move in the same direction, the estimate may overstate the impact of changing exchange rates on the net fair value of the Company s financial derivatives. It is also important to note that gains and losses indicated in the sensitivity analysis would generally be offset by gains and losses on the underlying exposures being hedged.

*Interest Rate Risk*

The Company monitors its exposure to interest rate risk principally in relation to fixed-rate and variable-rate debt. The Company uses derivative financial instruments to reduce exposure to fluctuations in interest rates in connection with its risk management policies. Accordingly, the Company has entered into certain fixed-for-variable and variable-for-fixed interest rate swap agreements to manage such interest rate exposures. The Company has entered into interest rate swaps for a portion of the 8.25% notes due August 1, 2010 ($125 million) and a portion of the 7.00% notes due March 10, 2014 ($225 million). These interest rate swaps effectively convert the designated portions of these notes from fixed interest rate to variable interest rate instruments. Additionally, the Company has entered into interest rate swaps for a portion of the $1.5 billion term loan due in 2013 ($200 million), effectively converting the designated portion of this loan from a variable interest rate to a fixed interest rate instrument. Approximately 34% and 43% of the Company s borrowings were effectively on a fixed rate basis as of June 30, 2007 and December 31, 2006, respectively.

As of June 30, 2007 and December 31, 2006, the net fair value of interest rate swaps was a liability of $20 million and $18 million, respectively. The potential loss in fair value of these swaps from a hypothetical 50 basis point adverse change in interest rates would be approximately $4 million as of June 30, 2007 and December 31, 2006. The annual increase in pre-tax interest expense from a hypothetical 50 basis point adverse change in variable interest rates (including the impact of interest rate swaps) would be approximately $9 million and $6 million as of June 30, 2007 and December 31, 2006, respectively. This analysis may overstate the adverse impact on net interest expense because of the short-term nature of the Company s interest bearing investments.

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*Commodity Risk*

The Company s exposure to market risks from changes in the price of commodities including steel products, plastic resins, aluminum, natural gas and diesel fuel are not hedged due to a lack of acceptable hedging instruments in the market. The Company s exposures to price changes in such commodities are attempted to be addressed through negotiations with the Company s suppliers and customers, although there can be no assurance that the Company will not have to absorb any or all price increases and/or surcharges. When and if acceptable hedging instruments are available in the market, management will determine at that time if financial hedging is appropriate, depending upon the Company s exposure level at that time, the effectiveness of the financial hedge and other factors.

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## ITEM 4. CONTROLS AND PROCEDURES

*Disclosure Controls and Procedures*

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports the Company files with the SEC under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to the Company s management, including its CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

The Company s management carried out an evaluation, under the supervision and with the participation of the CEO and the CFO, of the effectiveness of the design and operation of the Company s disclosure controls and procedures as of June 30, 2007. Based upon that evaluation, the CEO and CFO concluded that the Company s disclosure controls and procedures were effective.

*Changes in Internal Control over Financial Reporting*

There were no changes in the Company s internal control over financial reporting during the quarter ended June 30, 2007 that have materially effected, or are reasonably likely to materially effect, the Company s internal control over financial reporting.

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## PART II
## OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

See the information above under Note 19. Commitments and Contingencies, to the consolidated financial statements which is incorporated herein by reference.

### ITEM 1A. RISK FACTORS

For information regarding factors that could affect the Company s results of operations, financial condition and liquidity, see the risk factors discussed in Part I, Item 1A. Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2006. See also, Cautionary Statements Regarding Forward-Looking Information included in Part I, Item 2 of this Quarterly Report on Form 10-Q.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Annual Meeting of Stockholders was held on May 16, 2007. At the meeting, the following matters were submitted to a vote of the stockholders:

(1) The election of three directors to serve for a one-year term beginning at the 2007 annual meeting of stockholders and expiring at the 2008 annual meeting of stockholders.

| Nominee | For | Withheld |
|---|---|---|
| Patricia L. Higgins | 104,523,397 | 11,988,150 |
| Michael F. Johnston | 108,507,216 | 8,004,331 |
| Karl J. Krapek | 102,526,115 | 13,985,432 |

(2) The ratification of the appointment of PricewaterhouseCoopers LLP as Visteon s independent registered public accounting firm for fiscal year 2007.

| For | Against | Abstain | Broker Non-Votes | | | | |
|---|---|---|---|---|---|---|---|
| N/A | $ | 0.35 | 8/15/14 | 8/29/14 | N/A | $0.35 | |

The Company anticipates the ongoing payment of semi-annual dividends in subsequent periods, although the actual declaration of future dividends, the amount of such dividends, and the establishment of record and payment dates is subject to final determination by the Board of Directors at its discretion after its review of the Company’s financial performance and anticipated capital requirements.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Comprehensive Income and Accumulated Other Comprehensive Loss

The following tables disclose the effects of each component of other comprehensive income (loss), net of tax (in thousands):

| | Six Months Ended February 28, 2015 | | | |
|---|---|---|---|---|
| | Foreign currency translation adjustments | Defined benefit pension plans | Derivative Instruments | Total |
| Beginning balance, September 1, 2014 | $(50,410) | $113 | $1,011 | $(49,286) |
| Other comprehensive income (loss) | (22,557) | (24) | 3,468 | (19,113) |
| Ending balance, February 28, 2015 | $(72,967) | $89 | $4,479 | $(68,399) |

| | Six Months Ended February 28, 2014 | | | |
|---|---|---|---|---|
| | Foreign currency translation adjustments | Defined benefit pension plans | Derivative Instruments | Total |
| Beginning balance, September 1, 2013 | $(42,321) | $(152) | $998 | $(41,475) |
| Other comprehensive income (loss) | (12,372) | 11 | 922 | (11,439) |
| Ending balance, February 28, 2014 | $(54,693) | $(141) | $1,920 | $(52,914) |

| | Twelve Months Ended August 31, 2014 | | | |
|---|---|---|---|---|
| | Foreign currency translation adjustments | Defined benefit pension plans | Derivative Instruments | Total |
| Beginning balance, September 1, 2013 | $(42,321) | $(152) | $998 | $(41,475) |
| Other comprehensive income (loss) | (8,089) | 260 | 101 | (7,728) |
| Amounts reclassified from accumulated other comprehensive income (loss) | — | 5 [2] | (88) [1] [3] | (83) |
| Ending balance, August 31, 2014 | $(50,410) | $113 | $1,011 | $(49,286) |

[1] See Note 9 - Derivative Instruments and Hedging Activities.

[2] Amounts reclassified from accumulated other comprehensive income (loss) related to the minimum pension liability are included in warehouse club operations in the Company's Consolidated Statements of Income.

[3] Amounts reclassified from accumulated other comprehensive income (loss) for settlement of derivative instruments are included in other income (expense), net in the Company's Consolidated Statements of Income.

Retained Earnings Not Available for Distribution

The following table summarizes retained earnings designated as legal reserves of various subsidiaries which cannot be distributed as dividends to PriceSmart, Inc. according to applicable statutory regulations (in thousands):

| | February 28, 2015 | August 31, 2014 |
|---|---|---|
| Retained earnings not available for distribution | $4,916 | $4,556 |

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PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 6 – STOCK BASED COMPENSATION

The three types of equity awards offered by the Company are stock options (“options”), restricted stock awards (“RSAs”) and restricted stock units (“RSUs”). Compensation related to options is accounted for by applying the valuation technique based on the Black-Scholes model. Compensation related to RSAs and RSUs is based on the fair market value at the time of grant with the application of an estimated forfeiture rate. The Company recognizes the compensation cost related to these awards over the requisite service period as determined by the grant, amortized ratably or on a straight line basis over the life of the grant. The Company utilizes “modified grant-date accounting” for true-ups due to actual forfeitures at the vesting dates. The Company records the tax savings resulting from tax deductions in excess of expense for stock-based compensation as additional paid-in capital and the tax deficiency resulting from stock-based compensation in excess of the related tax deduction as a reduction in paid-in capital, based on the Tax Law Ordering method. In addition, the Company reflects the tax savings (deficiency) resulting from the taxation of stock-based compensation as a financing cash flow in its consolidated statement of cash flows, rather than as an operating cash flow.

RSAs have the same cash dividend and voting rights as other common stock and are considered to be currently issued and outstanding shares of common stock. Shares of common stock underlying RSUs are not issued nor outstanding until the RSUs vest and RSUs do not have the same dividend and voting rights as common stock. However, all outstanding RSUs have accompanying dividend equivalents, requiring payment to the employees and directors with unvested RSUs of amounts equal to the dividend they would have received had the shares of common stock underlying the RSUs been actually issued and outstanding. Payments of dividend equivalents to employees are recorded as compensation expense.

The Company adopted the 2013 Equity Incentive Award Plan (the "2013 Plan") for the benefit of its eligible employees, consultants and non-employee directors on January 22, 2013. The 2013 Plan provides for awards covering up to (1) 600,000 shares of common stock plus (2) the number of shares that remained available for issuance as of January 22, 2013 under three equity participation plans previously maintained by the Company. The number of shares reserved for issuance under the 2013 Plan increases during the term of the plan by the number of shares relating to awards outstanding under the 2013 Plan or any of the prior plans that expire, or are forfeited, terminated, canceled or repurchased, or are settled in cash in lieu of shares and decreases due to award releases or option exercises. As of October 31, 2014, no more than an aggregate of 1,332,540 shares of the Company’s common stock will be issued under the 2013 Plan. The following table summarizes the shares authorized and shares available for future grants:

| | | Shares available to grant | |
|---|---|---|---|
| | Shares authorized for issuance as of October 31, 2014 (including shares originally authorized for issuance under the prior plans) | February 28, 2015 | August 31, 2014 |
| 2013 Plan | 888,353 | 854,864 | 821,124 |

The following table summarizes the components of the stock-based compensation expense (in thousands), which are included in general and administrative expense and warehouse club operations in the consolidated statements of income:

| | Three Months Ended February 28, | | Six Months Ended February 28, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Options granted to directors | $ 9 | $ 7 | $ 37 | $ 37 |
| Restricted stock awards | 1,454 | 1,634 | 2,703 | 2,783 |

| | | | | |
|---|---|---|---|---|
| Restricted stock units | 321 | 250 | 600 | 501 |
| Stock-based compensation expense | $ 1,784 | $ 1,891 | $ 3,340 | $ 3,321 |

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes other information related to stock-based compensation:

| | February 28, 2015 | 2014 |
|---|---|---|
| Remaining unrecognized compensation cost (in thousands) | $ 18,045 | $ 23,520 |
| Weighted average period of time over which this cost will be recognized (years) | 6 | 6 |
| Excess tax benefit (deficiency) on stock-based compensation (in thousands) | $ 1,457 | $ 1,345 |

The Company began issuing restricted stock awards in fiscal year 2006 and restricted stock units in fiscal year 2008. The restricted stock awards and units vest over a five to ten year period, and the unvested portion of the award is forfeited if the employee or non-employee director leaves the Company before the vesting period is completed. Restricted stock awards and units activity for the period was as follows:

| | Six Months Ended February 28, 2015 | 2014 |
|---|---|---|
| Grants outstanding at beginning of period | 488,416 | 623,424 |
| Granted | 16,911 | 8,316 |
| Forfeited | (720) | (1,732) |
| Vested | (136,779) | (135,371) |
| Grants outstanding at end of period | 367,828 | 494,637 |

The following table summarizes the weighted average per share grant date fair value for restricted stock awards and units for the period:

| | Six Months Ended February 28, | |
|---|---|---|
| Weighted Average Grant Date Fair Value | 2015 | 2014 |
| Restricted stock awards and units granted | $ 89.85 | $ 112.37 |
| Restricted stock awards and units vested | $ 44.21 | $ 39.71 |
| Restricted stock awards and units forfeited | $ 40.40 | $ 49.37 |

The following table summarizes the total fair market value of restricted stock awards and units vested for the period (in thousands):

| | Six Months Ended February 28, 2015 | 2013 |
|---|---|---|
| Total fair market value of restricted stock awards and units vested | $ 12,166 | $ 12,749 |

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PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

At the vesting dates of restricted stock awards, the Company repurchases shares at the prior day's closing price per share, with the funds used to pay the employees' minimum statutory tax withholding requirements. The Company expects to continue this practice going forward. The following table summarizes this activity during the period:

| | Six Months Ended February 28, | |
|---|---|---|
| | 2015 | 2014 |
| Shares repurchased | 49,931 | 48,291 |
| Cost of repurchase of shares (in thousands) | $4,441 | $4,548 |

The Company reissues treasury shares as part of its stock-based compensation programs. The following table summarizes the treasury shares reissued:

| | Six Months Ended February 28, | |
|---|---|---|
| | 2015 | 2014 |
| Reissued treasury shares | — | — |

The following table summarizes the stock options outstanding:

| | February 28, 2015 | August 31, 2014 |
|---|---|---|
| Stock options outstanding | 20,000 | 23,000 |

Due to the substantial shift from the use of stock options to restricted stock awards and units, the Company believes stock option activity is no longer significant and that any further disclosure on options is not necessary.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 7 – COMMITMENTS AND CONTINGENCIES

Legal Proceedings

From time to time, the Company and its subsidiaries are subject to legal proceedings, claims and litigation arising in the ordinary course of business and property ownership. The Company evaluates such matters on a case by case basis, and vigorously contests any such legal proceedings or claims which the Company believes are without merit. The Company establishes an accrual for legal proceedings if and when those matters reach a stage where they present loss contingencies that are both probable and reasonably estimable. In such cases, there may be a possible exposure to loss in excess of any amounts accrued. The Company monitors those matters for developments that would affect the likelihood of a loss and the accrued amount, if any, thereof, and adjusts the amount as appropriate. If the loss contingency at issue is not both probable and reasonably estimable, the Company does not establish an accrual, but will continue to monitor the matter for developments that will make the loss contingency both probable and reasonably estimable. If it is at least a reasonable possibility that a material loss will occur, the Company will provide disclosure regarding the contingency. The Company believes that the final disposition of the pending legal proceedings, claims and litigation will not have a material adverse effect on its financial position, results of operations or liquidity. It is possible, however, that the Company's future results of operations for a particular quarter or fiscal year could be impacted by changes in circumstances relating to such matters.

Taxes

The Company is required to file federal and state tax returns in the United States and various other tax returns in foreign jurisdictions. The preparation of these tax returns requires the Company to interpret the applicable tax laws and regulations in effect in such jurisdictions, which could affect the amount of tax paid by the Company. The Company, in consultation with its tax advisors, bases its tax returns on interpretations that are believed to be reasonable under the circumstances. The tax returns, however, are subject to routine reviews by the various taxing authorities in the jurisdictions in which the Company files its returns. As part of these reviews, a taxing authority may disagree with respect to the interpretations the Company used to calculate its tax liability and therefore require the Company to pay additional taxes.

The Company accrues an amount for its estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained.

In evaluating the exposure associated with various non-income tax filing positions, the Company accrues for probable and estimable exposures for non-income tax related tax contingencies. As of February 28, 2015 and August 31, 2014, the Company had recorded within other accrued expenses a total of $3.0 million and $3.1 million for various non-income tax related tax contingencies.

While the Company believes the recorded liabilities are adequate, there are inherent limitations in projecting the outcome of litigation, in estimating probable additional income tax liability taking into account uncertain tax positions and in evaluating the probable additional tax associated with various non-income tax filing positions. As such, the Company is unable to make a reasonable estimate of the sensitivity to change of estimates affecting its recorded liabilities. As additional information becomes available, the Company assesses the potential liability and revises its

estimates as appropriate.

During fiscal year 2014, the Company was required to make tax payments with respect to various income tax cases that it is currently appealing, and during the first quarter of fiscal year 2015, the Company received provisional tax assessments with respect to deductibility and withholdings. These payments and assessments are discussed in further detail within Note 2, Income Taxes.



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PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Other Commitments

The Company is committed under non-cancelable operating leases for the rental of facilities and land. Future minimum lease commitments for facilities under these leases with an initial term in excess of one year are as follows (in thousands):

| Years ended February 28, | Open Locations[1] |
|---|---|
| 2016 | $7,309 |
| 2017 | 9,785 |
| 2018 | 10,355 |
| 2019 | 10,326 |
| 2020 | 10,260 |
| Thereafter | 81,442 |
| Total | $129,477 |

(1) Operating lease obligations have been reduced by approximately $372,000 to reflect sub-lease income. Certain obligations under leasing arrangements are collateralized by the underlying asset being leased.

The Company is also committed to non-cancelable construction services obligations for various warehouse club developments and expansions. As of February 28, 2015 the Company has approximately $4.5 million in contractual obligations for construction services not yet rendered.

The Company has entered into land purchase option agreements that have not been recorded as commitments, for which the Company has recorded within the balance sheet approximately $1.6 million in restricted cash deposits and prepaid expenses. The land purchase option agreements can be canceled at the sole option of the Company. The Company does not have a time table of when or if it will exercise these land purchase options, due to the uncertainty related to the completion of the Company's due diligence review. The Company's due diligence review includes evaluations of the legal status of the property, the zoning and permitting issues related to acquiring approval for the construction and operation of a warehouse club and any other issues related to the property itself that could render the property unsuitable or limit the property's economic viability as a warehouse club site. If the purchase option agreements are all exercised, the cash use would be approximately $21.4 million.

See Note 10 - Unconsolidated Affiliates for a description of additional capital contributions that may be required in connection with joint ventures to develop commercial centers adjacent to PriceSmart warehouse clubs in Panama and Costa Rica.

The Company contracts for distribution center services in Mexico. The contract for this distribution center's services was renewed on December 31, 2015 for an additional three years, with the applicable fees and rates to be reviewed at the beginning of each calendar year. Future minimum service commitments related to this contract through the end of the contract term is approximately $414,000.

NOTE 8 – DEBT

Short-term borrowings consist of lines of credit which are secured by certain assets of the Company and its subsidiaries and in some cases are guaranteed by the Company as summarized below (in thousands):

| | Total Amount of Facilities | Facilities Used Short-term Borrowings | Letters of Credit | Facilities Available | Weighted average interest rate | |
|---|---|---|---|---|---|---|
| February 28, 2015 | $59,387 | $4,470 | $380 | $54,537 | 5.86 | % |
| August 31, 2014 | $61,869 | $— | $436 | $61,433 | N/A | |

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

As of February 28, 2015, we had approximately $40.0 million of short-term facilities in the U.S. that require us to comply with certain quarterly financial covenants, which include debt service and leverage ratios. As of February 28, 2015 and August 31, 2014, we were in compliance with respect to these covenants. Each of the facilities expires annually and is normally renewed.

The following table provides the changes in our long-term debt for the six months ended February 28, 2015:

| (Amounts in millions) | Current Portion of Long-term debt | Long-term debt | Total |
|---|---|---|---|
| Balances as of August 31, 2014 | $ 11,848 | $ 79,591 | $ 91,439 [1] |
| Proceeds from long-term debt incurred during the period: | | | |
| Panama subsidiary | 1,000 | 9,000 | 10,000 |
| Honduras subsidiary | 1,600 | 6,750 | 8,350 |
| Colombia subsidiary | 1,500 | 13,500 | 15,000 |
| Trinidad subsidiary | 907 | 2,720 | 3,627 |
| Repayments of long-term debt: | | | |
| Repayment of loan by Honduras subsidiary, originally entered into on January 12, 2012 with Scotiabank El Salvador, S.A. | (3,200) | — | (3,200) |
| Partial repayment of loan by Honduras subsidiary, originally entered into on March 7, 2014 with Banco de America Central Honduras, S.A. | — | (5,000) | (5,000) |
| Repayment of loan by Honduras subsidiary, originally entered into on March 6, 2010 with Banco del Pais, S.A. | (87) | — | (87) |
| Repayment of loan by Trinidad subsidiary, originally entered into on August 26, 2008 with Royal Bank of Trinidad and Tobago, Ltd. | (900) | (2,325) | (3,225) |
| Regularly scheduled loan payments | (579) | (4,567) | (5,146) |
| Reclassifications of long-term debt | 2,850 | (2,850) | — |
| Translation adjustments on foreign-currency debt of subsidiaries whose functional currency is not the U.S. dollar [2] | (147) | (6,491) | (6,638) |
| Balances as of February 28, 2015 | $ 14,792 | $ 90,328 | $ 105,120 [3] |

(1) The carrying amount cash assets assigned as collateral for this total was $24.6 million and the carrying amount on non-cash assets assigned as collateral for this total was $84.2 million.
(2) These foreign currency translation adjustments are recorded within Other comprehensive income.
(3) The carrying amount cash assets assigned as collateral for this total was $24.0 million and the carrying amount on non-cash assets assigned as collateral for this total was $103.5 million.

As of February 28, 2015, the Company had approximately $78.3 million of long-term loans in Trinidad, Panama, El Salvador, Honduras and Colombia that require these subsidiaries to comply with certain annual or quarterly financial

covenants, which include debt service and leverage ratios. As of February 28, 2015, we were in compliance with all covenants or amended covenants.

As of August 31, 2014, we had approximately $62.5 million of long-term loans in Trinidad, Panama, El Salvador, Honduras and Colombia that require these subsidiaries to comply with certain annual or quarterly financial covenants, which include debt service and leverage ratios. As of August 31, 2014, we were in compliance with all covenants or amended covenants.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Annual maturities of long-term debt are as follows (in thousands):

| Twelve months ended February 28, | Amount |
|---|---|
| 2016 | $14,792 |
| 2017 | 29,679 |
| 2018 | 12,626 |
| 2019 | 12,176 |
| 2020 | 32,021 |
| Thereafter | 3,826 |
| Total | $105,120 |

NOTE 9 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company is exposed to certain risks relating to its ongoing business operations. One risk managed by the Company using derivative instruments is interest rate risk. To manage interest rate exposure, the Company enters into hedge transactions (interest rate swaps) using derivative financial instruments. The objective of entering into interest rate swaps is to eliminate the variability of cash flows in the LIBOR interest payments associated with variable-rate loans over the life of the loans. As changes in interest rates impact the future cash flow of interest payments, the hedges provide a synthetic offset to interest rate movements.

In addition, the Company is exposed to foreign currency and interest rate cash flow exposure related to non-functional currency long-term debt of two of our wholly owned subsidiaries. To manage foreign currency and interest rate cash flow exposure, these subsidiaries enter into cross-currency interest rate swaps that convert their U.S. dollar denominated floating interest payments to functional currency fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of interest payments, the hedges are intended to offset changes in cash flows attributable to interest rate and foreign exchange movements.

These derivative instruments (cash flow hedging instruments) are designated and qualify as cash flow hedges, with the effective portion of the gain or loss on the derivative reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction is determined to be ineffective. There were no such amounts recorded for ineffectiveness for the periods reported herein related to the interest rate or cross-currency interest rate swaps of long-term debt.

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business, particularly in the case of U.S. dollar denominated liabilities within its international subsidiaries whose functional currency is other than the U.S. dollar. The Company manages these fluctuations, in part, through the use of non-deliverable forward foreign-exchange contracts that are intended to offset changes in cash flow attributable to currency exchange movements. These contracts are intended primarily to economically address exposure to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries whose functional currency is other than the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. The Company seeks to mitigate foreign-currency exchange-rate risk with the use of these contracts and does not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features.

Cash Flow Hedges

The Company formally documents the hedging relationships for its derivative instruments that qualify for hedge accounting. As of February 28, 2015, all of the Company's interest rate swap and cross-currency interest rate swap derivative financial instruments are designated and qualify as cash flow hedges. The cross-currency interest rate swap agreements convert the Company's subsidiary's foreign currency United States dollar denominated floating interest payments on long-term debt to the functional currency fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of interest payments, the hedge is intended to offset changes in cash flows attributable to interest rate and foreign currency exchange movements. Various subsidiaries entered into interest rate swap agreements that fix the interest rate over the life of the underlying loans. These derivative financial instruments were also designated and qualified as cash flow hedges.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes agreements for which the Company has recorded cash flow hedge accounting transactions during the six months ended February 28, 2015:

| Subsidiary | Date Entered into | Derivative Financial Counter-party | Derivative Financial Instruments | Initial US$ Notional Amount | Bank US$ loan Held with | Floating Leg (swap counter-party) | Fixed Rate for PSMT Subsidiary | | Settlement Dates | Effective Period of swap |
|---|---|---|---|---|---|---|---|---|---|---|
| El Salvador | 16-Dec-14 | Bank of Nova Scotia ("Scotiabank") | Interest rate swap | $4,000,000 | Bank of Nova Scotia | Variable rate 30-day Libor plus 3.5% | 4.78 | % | 29th day of each month beginning on December 29, 2014 | December 01, 2014 - August 29, 2019 |
| Colombia | 10-Dec-14 | Citibank, N.A. ("Citi") | Cross currency interest rate swap | $15,000,000 | Citibank, N.A. | Variable rate 3-month Libor plus 2.8% | 8.25 | % | 4th day of March, June, Sept, Dec. beginning on March 4, 2015 | December 4, 2014 - December 3, 2019 |
| Panama | 9-Dec-14 | Bank of Nova Scotia ("Scotiabank") | Interest rate swap | $10,000,000 | Bank of Nova Scotia | Variable rate 30-day Libor plus 3.5% | 5.159 | % | 28th day of each month beginning December 29, 2014 | November 28, 2014 - November 29, 2019 |
| Honduras | 23-Oct-14 | Citibank, N.A. ("Citi") | Cross currency interest rate swap | $5,000,000 | Citibank, N.A. | Variable rate 3-month Libor plus 3.5% | 11.6 | % | 22nd day of January, April, July, and October beginning on January 22, 2015 | October 22, 2014 - October 22, 2017 |
| Panama | 1-Aug-14 | Bank of Nova Scotia ("Scotiabank") | Interest rate swap | $5,000,000 | Bank of Nova Scotia | Variable rate 30-day Libor plus 3.5% | 4.89 | % | 21st day of each month beginning on September 22, 2014 | August 21, 2014 - August 21, 2019 |
| Panama | 22-May-14 | Bank of Nova Scotia ("Scotiabank") | Interest rate swap | $19,800,000 | Bank of Nova Scotia | Variable rate 30-day Libor plus 3.5% | 4.98 | % | 4th day of each month beginning on June 4, 2014 | May 5, 2014 - April 4, 2019 |
| Panama | 22-May-14 | | | $3,970,000 | | | 4.98 | % | | |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Bank of Nova Scotia ("Scotiabank") | Interest rate swap | | Bank of Nova Scotia | Variable rate 30-day Libor plus 3.5% | | | 4th day of each month beginning on June 4, 2014 | May 5, 2014 - April 4, 2019 |
| Colombia | 11-Dec-12 | Bank of Nova Scotia ("Scotiabank") | Cross currency interest rate swap | $8,000,000 | Bank of Nova Scotia | Variable rate 3-month Libor plus 0.7% | 4.79 | % | March, June, September and December, beginning on March 5, 2013 | December 5, 2012 - December 5, 2014 |
| Colombia | 21-Feb-12 | Bank of Nova Scotia ("Scotiabank") | Cross currency interest rate swap | $8,000,000 | Bank of Nova Scotia | Variable rate 3-month Libor plus 0.6% | 6.02 | % | February, May, August and November beginning on May 22, 2012 | February 21, 2012 - February 21, 2017 |
| Colombia | 21-Oct-11 | Bank of Nova Scotia ("Scotiabank") | Cross currency interest rate swap | $2,000,000 | Bank of Nova Scotia | Variable rate 3-month Libor plus 0.7% | 5.30 | % | January, April, July and October, beginning on October 29, 2011 | July 29, 2011 - April 1, 2016 |
| Colombia | 21-Oct-11 | Bank of Nova Scotia ("Scotiabank") | Cross currency interest rate swap | $6,000,000 | Bank of Nova Scotia | Variable rate 3-month Libor plus 0.7% | 5.45 | % | March, June, September and December, beginning on December 29, 2011 | September 29, 2011 - April 1, 2016 |
| Colombia | 5-May-11 | Bank of Nova Scotia ("Scotiabank") | Cross currency interest rate swap | $8,000,000 | Bank of Nova Scotia | Variable rate 3-month Libor plus 0.7% | 6.09 | % | January, April, July and October, beginning on July 5, 2011 | April 1, 2011 - April 1, 2016 |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

For the three and six-month period ended February 28, 2015 and 2014, the Company included the gain or loss on the hedged items (that is, variable-rate borrowings) in the same line item—interest expense—as the offsetting gain or loss on the related interest rate swaps as follows (in thousands):

| Income Statement Classification | Interest expense on borrowings[1] | Cost of swaps [2] | Total |
|---|---|---|---|
| Interest expense for the three months ended February 28, 2015 | $584 | $714 | $1,298 |
| Interest expense for the three months ended February 28, 2014 | $113 | $334 | $447 |
| Interest expense for the six months ended February 28, 2015 | $933 | $1,226 | $2,159 |
| Interest expense for the six months ended February 28, 2014 | $240 | $764 | $1,004 |

(1) This amount is representative of the interest expense recognized on the underlying hedged transactions.
(2) This amount is representative of the interest expense recognized on the cross-currency interest rate swaps designated as cash flow hedging instruments.

The total notional balance of the Company's pay-fixed/receive-variable interest rate swaps and cross-currency interest rate swaps was as follows (in thousands):

| Floating Rate Payer (Swap Counterparty) | February 28, 2015 | August 31, 2014 |
|---|---|---|
| Scotiabank | $64,058 | $60,200 |
| Citibank N.A. | 19,750 | — |
| Total | $83,808 | $60,200 |

The following table summarizes the fair value of interest rate swap and cross-currency interest rate swap derivative instruments that qualify for derivative hedge accounting (in thousands, except footnote data):

| | February 28, 2015 | | August 31, 2014 | |
|---|---|---|---|---|
| Derivatives designated as cash flow hedging instruments | Balance Sheet Account | Fair Value | Balance Sheet Account | Fair Value |
| Cross-currency interest rate swaps[1] | Prepaid expenses and current assets | $— | Prepaid expenses and current assets | $495 |
| Cross-currency interest rate swaps[1] | Other non-current assets | 6,996 | Other non-current assets | 970 |
| Interest rate swaps[2] | Other non-current assets | — | Other non-current assets | 125 |
| Interest rate swaps[2] | Other long-term liabilities | (340) | Other long-term liabilities | — |
| Cross-currency interest rate swaps[3] | Other long-term liabilities | (246) | Other long-term liabilities | — |
| Net fair value of derivatives designated as hedging instruments - assets (liability)[4] | | $6,410 | | $1,590 |

(1) The effective portion of the cross-currency interest rate swaps for this subsidiary was recorded to Accumulated other comprehensive (income)/loss for $(4.9) million and $(917,000) net of tax as of February 28, 2015 and August 31, 2014, respectively. The Company has recorded a deferred tax liability amount with an offset to other

comprehensive income - tax of $(2.1) million and $(548,000) as of February 28, 2015 and August 31, 2014, respectively, related to asset positions of cross-currency interest rate swaps. However, the equity effect of this deferred tax liability is offset by the full valuation allowance provided for the net deferred tax asset recorded for this subsidiary.

(2) The effective portion of the interest rate swaps was recorded to Accumulated other comprehensive loss / (income) for $254,000 and $(94,000) net of tax as of February 28, 2015 and August 31, 2014, respectively. The Company has recorded a deferred

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

tax asset / (liability) amount with an offset to other comprehensive income - tax of $86,000 and $(31,000) as of February 28, 2015 and August 31, 2014, respectively.

(3) The effective portion of the cross-currency interest rate swaps for this subsidiary was recorded to Accumulated other comprehensive (income)/loss for $172,000 and $0 net of tax as of February 28, 2015 and August 31, 2014, respectively. The Company has recorded a deferred tax asset amount with an offset to other comprehensive income - tax of $74,000 and $0 as of February 28, 2015 and August 31, 2014, respectively.

(4) Derivatives listed on the above table were designated as cash flow hedging instruments.

Fair Value Instruments

The Company has entered into non-deliverable forward foreign-exchange contracts. These contracts are treated for accounting purposes as fair value contracts and do not qualify for derivative hedge accounting. The use of non-deliverable forward foreign-exchange contracts is intended to offset changes in cash flow attributable to currency exchange movements. These contracts are intended primarily to economically hedge exposure to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries whose functional currency is other than the U.S. dollar. The Company entered into non-deliverable forward foreign exchange contracts during the six months ended February 28, 2015. The open contracts as of February 28, 2015 are summarized below:

| Subsidiary | Dates entered into | Derivative Financial Counter-party | Derivative Financial Instrument | Notional Amount (in thousands) | Settlement Date | Effective Period of Forward |
|---|---|---|---|---|---|---|
| Colombia | January - February 2015 | Bank of Nova Scotia | Forward foreign exchange contracts | $27,000 | March - April 2015 | January - April 2015 |

For the three and six-month periods ended February 28, 2015 and 2014, the Company included in its consolidated statements of income the forward derivative gain or (loss) on the non-deliverable forward foreign-exchange contracts as follows (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| Income Statement Classification | February 28, 2015 | February 28, 2014 | February 28, 2015 | February 28, 2014 |
| Other income (expense), net | $3,521 | $62 | $6,134 | $185 |

The following table summarizes the fair value of foreign currency forward contracts that do not qualify for derivative hedge accounting (in thousands):

| | February 28, 2015 | | August 31, 2014 | |
|---|---|---|---|---|
| Derivatives designated as fair value hedging instruments | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Foreign currency forward contracts | Prepaid expenses and other current assets | $1,064 | Prepaid expenses and other current assets | $— |
| Foreign currency forward contracts | Other accrued expenses | — | Other accrued expenses | (14) |
| Net fair value of derivatives designated as hedging instruments that do not qualify for hedge | | $1,064 | | $(14) |

accounting

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 10 – UNCONSOLIDATED AFFILIATES

The Company determines whether any of the joint ventures in which it has made investments is a Variable Interest Entity (“VIE”) at the start of each new venture and if a reconsideration event has occurred. At this time, the Company also considers whether it must consolidate a VIE and/or disclose information about its involvement in a VIE. A reporting entity must consolidate a VIE if that reporting entity has a variable interest (or combination of variable interests) that will absorb a majority of the VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. A reporting entity must consider the rights and obligations conveyed by its variable interests and the relationship of its variable interests with variable interests held by other parties to determine whether its variable interests will absorb a majority of a VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. The reporting entity that consolidates a VIE is called the primary beneficiary of that VIE.

In 2008, the Company entered into real estate joint ventures to jointly own and operate separate commercial retail centers adjacent to warehouse clubs in Panama (Golf Park Plaza, S.A.) and Costa Rica (Plaza Alajuela, S.A.). Due to the initial nature of the joint ventures and the continued commitments for additional financing, the Company determined these joint ventures are VIEs. Since all rights and obligations are equally absorbed by both parties within each joint venture, the Company has determined that it is not the primary beneficiary of the VIEs and, therefore, has accounted for these entities under the equity method. Under the equity method, the Company's investments in unconsolidated affiliates are initially recorded as an investment in the stock of an investee at cost and are adjusted for the carrying amount of the investment to recognize the investor's share of the earnings or losses of the investee after the date of the initial investment.

On December 12, 2013, the Company entered into a lease agreement for approximately 17,976 square feet (1,670 square meters) of land with Golf Park Plaza, S.A. upon which the Company constructed its central offices in Panama. Construction of the offices was completed in October 2014. The lease term is for 15 years with three options to renew for five years each at the Company's discretion. The monthly lease expense is approximately $8,800. For the three and six months ended February 28, 2015, the Company recognized rent expense of $26,400 and $52,800, respectively, for this lease.

The table below summarizes the Company’s interest in these VIEs and the Company’s maximum exposure to loss as a result of its involvement with these VIEs as of February 28, 2015 (in thousands):

| Entity | % Ownership | Initial Investment | Additional Investments | Net Loss Inception to Date | Company’s Variable Interest in Entity | Commitment to Future Additional Investments [1] | Company’s Maximum Exposure to Loss in Entity[2] |
|---|---|---|---|---|---|---|---|
| GolfPark Plaza, S.A. | 50 % | $4,616 | $2,283 | $(81 ) | $6,818 | $217 | $7,035 |
| Price Plaza Alajuela, S.A. | 50 % | 2,193 | 1,236 | (2 ) | 3,427 | 785 | 4,212 |
| Total | | $6,809 | $3,519 | $(83 ) | $10,245 | $1,002 | $11,247 |

(1) The parties intend to seek alternate financing for the project, which could reduce the amount of investments each party would be required to provide. The parties may mutually agree on changes to the project, which could increase or decrease the amount of contributions each party is required to provide.

(2) The maximum exposure is determined by adding the Company's variable interest in the entity and any explicit or implicit arrangements that could require the Company to provide additional financial support.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The summarized financial information of the unconsolidated affiliates is as follows (in thousands):

| | February 28, 2015 | August 31, 2014 |
|---|---|---|
| Current assets | $1,246 | $803 |
| Noncurrent assets | $11,499 | $8,900 |
| Current liabilities | $1,418 | $1,126 |
| Noncurrent liabilities | $13 | $13 |

| | Three Months Ended February 28, | | Six Months Ended February 28, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net income (loss) | $15 | $— | $27 | $8 |

NOTE 11 – SEGMENTS

The Company and its subsidiaries are principally engaged in the operation of membership shopping warehouse clubs in 13 countries/territories that are located in Latin America and the Caribbean. In addition, the Company operates distribution centers and corporate offices in the United States. The Company’s reportable segments are based on management’s organization of these locations into operating segments by general geographic location, which are used by management in setting up management lines of responsibility, providing support services, and making operational decisions and assessments of financial performance.

During the second quarter of fiscal year 2015, the Company added to its operating segments, the Colombia Operations, and desegregated the Colombia Operations from the Latin America Operations, renaming that segment Central America Operations. The Company has made this change as a result of the information that the Company's chief operating decision maker regularly reviews for purposes of allocating resources and assessing performance and the growing level of investment and sales activity in Colombia. Therefore, beginning in the second quarter of fiscal year 2015, the Company has reported its financial performance based on these new segments and has retrospectively adopted this change for the disclosure of financial information presented by segment. The Company’s operating segments are the United States, Central America, the Caribbean and Colombia. Additionally, certain inter-company charges are no longer allocated to the segments within this presentation and now appear as reconciling items to reflect the amount eliminated on consolidation of intersegment transactions. This presentation more closely reflects the information reviewed by the Company's chief operating decision maker. Segment amounts are presented after converting to U.S. dollars and consolidating eliminations. Certain revenues and operating costs included in the United States segment have not been allocated, in order to reflect the information reviewed by the Company's chief operating decision maker or it is impractical to do so.

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company has made reclassifications to the consolidated balance sheet recorded during fiscal year 2015 (see Note 1 - Company Overview and Basis of Presentation) to the consolidated balance sheet for fiscal year 2014 to conform to the presentation in fiscal year 2015. These reclassifications did not impact net income. The following tables summarize the impact of these reclassifications to the amounts reported for each segment (in thousands):

| | United States Operations | Central American Operations | Caribbean Operations | Colombia Operations | Total |
|---|---|---|---|---|---|
| Six Month Period Ended February 28, 2014 | | | | | |
| Long-lived assets (other than deferred tax assets) as previously reported | $ 13,087 | $ 257,053 | $ 115,316 | $ 87,295 | $ 472,751 |
| Reclassifications to long-lived assets | 65 | 965 | — | 767 | 1,797 |
| Long-lived assets (other than deferred tax assets) as currently reported | $ 13,152 | $ 258,018 | $ 115,316 | $ 88,062 | $ 474,548 |
| | | | | | |
| Total assets as previously reported | $ 57,377 | $ 436,252 | $ 218,513 | $ 122,174 | $ 834,316 |
| Reclassifications to total assets | — | 72 | — | — | 72 |
| Total assets as currently reported | $ 57,377 | $ 436,324 | $ 218,513 | $ 122,174 | $ 834,388 |
| | | | | | |
| As of August 31, 2014 | | | | | |
| Long-lived assets (other than deferred tax assets) as previously reported | $ 16,488 | $ 265,950 | $ 113,134 | $ 130,330 | $ 525,902 |
| Reclassifications to long-lived assets | 96 | 2,096 | — | 970 | 3,162 |
| Long-lived assets (other than deferred tax assets) as currently reported | $ 16,584 | $ 268,046 | $ 113,134 | $ 131,300 | $ 529,064 |
| | | | | | |
| Total assets as previously reported | $ 91,190 | $ 457,325 | $ 223,251 | $ 168,452 | $ 940,218 |
| Reclassifications to total assets | (15) | 70 | — | (2,203) | (2,148) |
| Total assets as currently reported | $ 91,175 | $ 457,395 | $ 223,251 | $ 166,249 | $ 938,070 |

PRICESMART, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following tables summarize by segment certain revenues, operating costs and balance sheet items (in thousands):

| | United States Operations | Central American Operations | Caribbean Operations | Colombia Operations | Reconciling Items[1] | Total |
|---|---|---|---|---|---|---|
| Three Month Period Ended February 28, 2015 | | | | | | |
| Revenue from external customers | $6,235 | $426,226 | $220,225 | 97,610 | | $750,296 |
| Intersegment revenues | 259,611 | — | 1,507 | — | (261,118 ) | — |
| Depreciation and amortization | 545 | 3,698 | 2,451 | 1,942 | | 8,636 |
| Operating income | 7,811 | 37,122 | 13,408 | (844 ) | (15,789 ) | 41,708 |
| Net income | 3,619 | 28,846 | 11,579 | (3,420 ) | (15,789 ) | 24,835 |
| Capital expenditures, net | 1,332 | 8,425 | 1,666 | 2,827 | | 14,250 |
| Six Month Period Ended February 28, 2015 | | | | | | |
| Revenue from external customers | $14,666 | $809,390 | $418,616 | $163,645 | $— | $1,406,317 |
| Intersegment revenues | 597,939 | — | 2,890 | — | (600,829 ) | — |
| Depreciation and amortization | 1,087 | 7,342 | 4,739 | 3,265 | — | 16,433 |
| Operating income | 15,714 | 68,254 | 25,577 | (1,781 ) | (29,771 ) | 77,993 |
| Net income | 6,981 | 53,174 | 21,833 | (6,735 ) | (29,771 ) | 45,482 |
| Capital expenditures, net | (1,441 )[2] | 23,231 | 4,862 | 17,218 | — | 43,870 |
| Long-lived assets (other than deferred tax assets) | 14,045 | 284,661 | 112,877 | 122,786 | — | 534,369 |
| Goodwill | — | 31,381 | 4,688 | — | — | 36,069 |
| Total assets | 62,021 | 492,395 | 241,096 | 190,854 | — | 986,366 |
| Three Month Period Ended February 28, 2014 | | | | | | |
| Revenue from external customers | $6,764 | $403,087 | $212,366 | 52,157 | $— | $674,374 |
| Intersegment revenues | 209,102 | — | 1,143 | — | (210,245 ) | — |
| Depreciation and amortization | 583 | 3,279 | 2,264 | 1,013 | — | 7,139 |
| Operating income | 5,904 | 34,076 | 12,939 | 1,973 | (15,517 ) | 39,375 |
| Net income | 2,451 | 28,919 | 11,040 | 1,385 | (15,517 ) | 28,278 |
| Capital expenditures, net | 3,565 | 9,269 | 1,710 | 25,264 | — | 39,808 |
| Six Month Period Ended February 28, 2014 | | | | | | |
| Revenue from external customers | $12,485 | $762,622 | $404,426 | $100,442 | $— | $1,279,975 |
| Intersegment revenues | 514,694 | — | 2,619 | — | (517,313 ) | — |
| Depreciation and amortization | 1,155 | 6,107 | 4,483 | 2,048 | — | 13,793 |
| Operating income | 12,853 | 61,163 | 22,397 | 3,473 | (28,152 ) | 71,734 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net income | 5,517 | 50,810 | 19,340 | 2,195 | (28,152 ) | 49,710 |
| Capital expenditures, net | 3,139 | 22,922 | 5,663 | 26,372 | — | 58,096 |
| Long-lived assets (other than deferred tax assets) | 13,152 | 258,018 | 115,316 | 88,062 | — | 474,548 |
| Goodwill | — | 31,530 | 4,791 | — | — | 36,321 |
| Total assets | 57,377 | 436,324 | 218,513 | 122,174 | — | 834,388 |
| | | | | | | |
| As of August 31, 2014 | | | | | | |
| Long-lived assets (other than deferred tax assets) | $16,584 | $268,046 | $113,134 | $131,300 | $ — | $529,064 |
| Goodwill | — | 31,383 | 4,725 | — | — | 36,108 |
| Total assets | 91,175 | 457,395 | 223,251 | 166,249 | — | 938,070 |

(1) The reconciling items reflect the amount eliminated on consolidation of intersegment transactions.

(2) The decrease in capital expenditures is a result of the transfers of capital assets from this segment to other segments.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 12 – SUBSEQUENT EVENTS

The Company has evaluated all events subsequent to the balance sheet date of February 28, 2015 through the date of issuance of these consolidated financial statements and have determined that, except as set forth below, there are no subsequent events that require disclosure.

Financing Transactions
On March 26, 2015, the Company's Honduras subsidiary paid down the outstanding principal balance of 179.3 million Lempiras, approximately US $8.2 million of the loan agreement entered into by the subsidiary on March 7, 2014 with Banco de America Central Honduras, S.A. The original agreement established a loan facility of 286.0 million Lempiras, approximately US$13.7 million. The interest rate was variable set a a minimum of 12.5% (12.75% at the time of pay-off). The loan term was for ten years with quarterly interest and principal payments, subject to a 24-month grace period on principal payments. The subsidiary has paid down this loan, and this loan facility has terminated.
On March 24, 2015, the Company's Honduras subsidiary entered into a loan agreement with Citibank, N.A. The agreement establishes a credit facility for $8.5 million with a variable interest rate of three-month LIBOR plus 3.25%. The loan term is for five years with quarterly interest and principal payments. This loan is secured by assets of the Company's Honduras subsidiary. The loan was funded at execution.

Cross-currency interest rate swap derivative transactions that qualify for derivative hedge accounting
On March 23, 2015, the Company's Honduras subsidiary entered into a cross-currency interest rate swap agreement with Citibank, N.A. for a notional amount of $8.5 million. The cross-currency interest rate swap agreement converts the Honduras subsidiary foreign currency United States dollar denominated principal and floating interest payments on the $8.5 million long-term quarterly amortizing debt with Citibank to functional currency principal and fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of principal and interest payments, the hedge is intended to offset changes in cash flows attributable to interest rate and foreign exchange movements. The hedged loan has a variable interest rate of three-month LIBOR plus 3.25%. Under the cross-currency interest rate swap agreement, the Company will receive variable U.S. dollar principal and interest based on the three-month LIBOR rate plus 3.25% on a quarterly amortizing notional amount of US $8.5 million and pay fixed interest of 10.75% on a quarterly amortizing notional amount of 185.6 million Honduran Lempiras for a term of approximately five years (effective date of March 24,2015 through March 20, 2020). The LIBOR reset dates for the hedged long-term debt and the cross-currency interest rate swap occur on the twenty fourth day of March, June, September, and December beginning on June 24, 2015.

Non-deliverable forward foreign-exchange contracts
The Company's Colombia subsidiary has entered into forward exchange contracts for approximately $8.0 million with settlement dates of April 2015.

PRICESMART, INC.

## ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q contains forward-looking statements concerning PriceSmart Inc.'s ("PriceSmart", the "Company" or "we") anticipated future revenues and earnings, adequacy of future cash flow, proposed warehouse club openings, the Company's performance relative to competitors, the outcome of tax proceedings and related matters. These forward-looking statements include, but are not limited to, statements containing the words “expect,” “believe,” “will,” “may,” “should,” “project,” “estimate,” “anticipated,” “scheduled,” and like expressions, and the negative the These statements are subject to risks and uncertainties that could cause actual results to differ materially, including the following risks: our financial performance is dependent on international operations, which exposes us to various risks; any failure by us to manage our widely dispersed operations could adversely affect our business; we face significant competition; future sales growth depends, in part, on our ability to successfully open new warehouse clubs; we might not identify in a timely manner or effectively respond to changes in consumer preferences for merchandise, which could adversely affect our relationship with members, demand for our products and market share; although we have begun to offer limited online shopping to our members, our sales could be adversely affected if one or more major international online retailers were to enter our markets or if other competitors were to offer a superior online experience; we face difficulties in the shipment of, and inherent risks in the importation of, merchandise to our warehouse clubs; we are exposed to weather and other natural disaster risks; general economic conditions could adversely impact our business in various respects; we are subject to risks associated with possible changes in our relationships with third parties with which we do business, as well as the performance of such third parties; we rely extensively on computer systems to process transactions, summarize results and manage our business, and failure to adequately maintain our systems or disruptions in our systems could harm our business and adversely affect our results of operations; we could be subject to additional tax liabilities; a few of our stockholders own approximately 28.1% of our voting stock as of February 28, 2015, which may make it difficult to complete some corporate transactions without their support and may impede a change in control; our inability to develop and retain existing key personnel or to attract highly qualified employees could adversely impact our business, financial condition and results of operations; we are subject to volatility in foreign currency exchange rates; we face the risk of exposure to product liability claims, a product recall and adverse publicity; if we do not maintain the privacy and security of confidential information, we could damage our reputation, incur substantial additional costs and become subject to litigation; we are subject to payment related risks; changes in accounting standards and assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our financial condition and results of operations; we face increased public company compliance risks and compliance risks related to our international operations; we face increased compliance risks associated with compliance with Section 404 of the Sarbanes-Oxley Act of 2002; and if remediation costs or hazardous substance contamination levels at certain properties for which we maintain financial responsibility exceed management's current expectations, our financial condition and results of operations could be adversely impacted. The risks described above as well as the other risks detailed in the Company's U.S. Securities and Exchange Commission (“SEC”) reports, including the Company's Annual Report on Form 10-K filed for the fiscal year ended August 31, 2014 on October 30, 2014 pursuant to the Securities Exchange Act of 1934, as amended, could materially and adversely affect our business, financial condition and results of operations. These risks are not the only risks that the Company faces. The Company could also be affected by additional factors that apply to all companies operating globally and in the U.S., as well as other risks that are not presently known to the Company or that the Company currently considers to be immaterial.

The following discussion and analysis compares the results of operations for the three- and six-month periods ended February 28, 2015 and 2014 and should be read in conjunction with the consolidated financial statements and the accompanying notes included therein.

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Our business consists primarily of operating international membership shopping warehouse clubs similar to, but smaller in size than, warehouse clubs in the United States. We operate in 13 countries/territories that are located in Latin America and the Caribbean. Our ownership in all operating subsidiaries as of February 28, 2015 is 100%, and they are presented on a consolidated basis. The number of warehouse clubs in operation as of February 28, 2015 for each country or territory are as follows:

| Country/Territory | Number of Warehouse Clubs in Operation as of February 28, 2015 | Number of Warehouse Clubs in Operation as of February 28, 2014 | Anticipated warehouse club openings within the next 12 months |
|---|---|---|---|
| Colombia | 6 | 3 | — |
| Costa Rica | 6 | 6 | — |
| Panama | 4 | 4 | 1 |
| Trinidad | 4 | 4 | — |
| Dominican Republic | 3 | 3 | — |
| Guatemala | 3 | 3 | — |
| El Salvador | 2 | 2 | — |
| Honduras | 3 | 2 | — |
| Aruba | 1 | 1 | — |
| Barbados | 1 | 1 | — |
| U.S. Virgin Islands | 1 | 1 | — |
| Jamaica | 1 | 1 | — |
| Nicaragua | 1 | 1 | — |
| Totals | 36 | 32 | 1 |

In addition, we operate distribution centers and corporate offices in the United States. Our reportable segments are based on management's organization of these locations into operating segments by general geographic location, which are used by management in setting up management lines of responsibility, providing support services, and making operational decisions and assessments of financial performance.

During the second quarter of fiscal year 2015, we added to our operating segments, the Colombia Operations, and desegregated the Colombia Operations from the Latin America Operations, renaming that segment Central America Operations. We made this change as a result of the information that our chief operating decision maker regularly reviews for purposes of allocating resources and assessing performance and the growing level of investment and sales activity in Colombia. Therefore, beginning in the second quarter of fiscal year 2015, we have reported our financial performance based on these new segments and have retrospectively adopted this change for the disclosure of financial information presented by segment. Our operating segments are the United States, Central America, the Caribbean and Colombia.

During October 2013, we opened our sixth membership warehouse club in Costa Rica in La Union, Cartago, and in May 2014, we opened our third warehouse club in Honduras in Tegucigalpa, our second in the capital city. In January 2014, we acquired land in Pereira, Colombia and in the city of Medellin, Colombia and leased land in the city of Bogota, Colombia. We built new warehouse clubs at these three sites, and opened the Bogota location in October 2014 and opened the other two Colombian sites in November 2014. Together with the three warehouse clubs that were operating prior to these openings in Colombia (one in Barranquilla and two in Cali), these three new clubs brought the number of PriceSmart warehouse clubs operating in Colombia to six. In September 2014, we acquired land in La Chorrera ("Costa Verde"), west of Panama City, Panama, on which our fifth PriceSmart warehouse club in Panama is scheduled to open in the summer of 2015.

Our warehouse clubs and local distribution centers are located in Latin America and the Caribbean, and our corporate headquarters, U.S. buying operations and regional distribution centers are located primarily in the United States. Our reportable segments are based on management's organization of these locations into operating segments by general geographic location. Our operating segments are the United States, Central America, the Caribbean, and Colombia.

General Economic Factors

Market conditions in the second fiscal quarter made for a challenging environment in some of our markets and could continue to have a dampening effect on overall sales growth in the next several fiscal quarters. In some PriceSmart markets, sales were negatively affected by various economic and social factors including lower prices for exported oil, crime and violence and generally weaker economies. Especially significant, the Colombian peso (COP) has devalued versus the U.S. dollar by approximately 29% from the beginning of the fiscal year (August 2014) until the end of the second fiscal quarter (February 2015). In the second fiscal quarter alone, the value of the peso versus the U.S. dollar declined 13%. This devaluation results in U.S. imports, which account for over 60% of PriceSmart sales in Colombia, becoming more expensive, thereby reducing demand for those imported products. In addition, the decline in the value of the Colombia Peso ("COP") negatively impacts warehouse sales and membership income priced in COP when converted to and reported in U.S. dollars. On the other hand, operating expenses within Colombia are lower when converted to U.S. dollars. Costa Rica also experienced an approximate 10% devaluation of the Costa Rican colon during January and February 2014, which had a negative effect on consumer activity for some period of time and impacted the year on year sales comparisons in the first fiscal quarter and for December and January in the current quarter. The Costa Rican currency has strengthened somewhat from that initial devaluation and is now at a level consistent with a year ago. Costa Rica and Colombia are two of our largest markets and therefore these macro-economic issues can have a measurable impact on our consolidated financial performance.

Managing Currency Fluctuations

Currency exchange rate fluctuations can impact net income as we revalue all U.S. dollar-denominated monetary assets and liabilities within our markets that do not use the U.S. dollar as their functional currency. These monetary assets and liabilities include, but are not limited to, excess cash permanently reinvested offshore, U.S. dollar-denominated long-term debt used to finance land acquisitions and the construction of warehouse clubs, and U.S. dollar-denominated accounts payable related to the purchase of merchandise. Approximately 42% of our net warehouse sales are derived from merchandise purchased in U.S. dollars and sold in non-U.S. dollar currencies.

We seek to minimize the impact of negative foreign exchange fluctuations on the Company's results by utilizing from time to time one or more of the following strategies: (1) adjusting prices on goods acquired in U.S. dollars on a periodic basis to maintain our target margins after taking into account changes in exchange rates and our competition; (2) obtaining local currency loans from banks within certain markets where it is economical to do so and where management believes the risk of devaluation and the level of U.S. dollar denominated liabilities warrants this action; (3) reducing the time between the acquisition of product in U.S. dollars and the settlement of that purchase in local currency; (4) maintaining a balance between assets held in local currency and in U.S. dollars; and (5) by entering into cross-currency interest rate swaps and forward currency derivatives. We have local-currency-denominated long-term loans in Honduras and Guatemala and have cross-currency interest rate swaps and forward currency derivatives in Colombia. We report the gains or losses associated with the revaluation of these monetary assets and liabilities on our Consolidated Statements of Income under the heading “Other income (expense), net.” Future volatility regarding currencies could have a material impact on our operations in future periods, however, there is no way to accurately forecast the impact of the change in rates on our future demand for imported products, reported sales, or financial results.

Competition

We do not currently face direct competition from U.S. branded membership warehouse club operators. However, we do face competition from various retail formats such as hypermarkets, supermarkets, cash and carry, home improvement centers, electronic retailers and specialty stores, including those within Central America that are owned and operated by a large U.S.-based retailer. We have competed effectively in these markets in the past and expect to continue to do so in the future due to the unique nature of the membership warehouse club format product offering

and overall value provided to the member. However, new retail competitors may enter our markets, existing retailers continue to invest and expand, and it is possible that U.S. warehouse club operators could enter our markets and compete more directly with us in a similar warehouse club format, although we have no current indication that such an event is imminent.

Business Strategy

Our business strategy is to offer for sale to businesses and families a limited number of stock keeping units (SKU's) covering a wide range of products at the lowest possible prices. We charge an annual membership fee to our customers. These fees combined with warehouse and distribution operating efficiencies and volume purchasing enable us to operate our business on lower merchandise margins than conventional retail stores. The combination of annual membership fees, operating efficiencies and low margins enable us to offer our members high quality merchandise at very competitive prices which, in turn, enhances the value of the PriceSmart membership.

Current and Future Management Actions

Generally, our operating efficiencies, earnings and cash flow from operations improve as sales increase. Higher sales provide greater purchasing power and often result in lower product prices from our suppliers. Further, increased sales permit us to leverage our selling, general and administrative expenses. It is our business strategy to pass along to our members the savings we receive from better purchasing and more efficient operations through lower merchandise prices, increasing the value our members receive which then further drives sales and increases volume. Therefore, we prioritize initiatives that we expect will have the greatest impact on increasing sales, particularly within our existing locations. Looking forward to the next several quarters, the following actions are likely to have an impact on our business and the results of operations.

We seek to increase sales by increasing transaction size and frequency with existing members in our warehouse clubs, by attracting new members to our clubs and by adding new warehouse clubs. Our continued focus on initiatives to increase comparable warehouse club sales within existing warehouse clubs locations resulted in a 1.4% increase in comparable warehouse club sales for the 13-week period ended February 28, 2015 compared to the same 13-week period the prior year. During the first quarter of fiscal 2014, we opened our sixth membership warehouse club in Costa Rica in La Union, Cartago, and in the third quarter opened our third warehouse club in Honduras. In both cases, these new clubs negatively impacted reported comparable warehouse club sales during the quarter as warehouse sales transferred to these new clubs from existing clubs. This comparable warehouse club sales growth combined with the addition of two new warehouse clubs in fiscal year 2014 and the opening of our three new Colombia warehouse clubs during the first quarter of fiscal year 2015 resulted in an 11.4% increase in warehouse club sales compared to a year ago. In addition, the Company increased the number of member accounts 20.1% over the prior year at quarter end.

Membership is a unique and critical feature of the warehouse club business model. The annual fee for a Diamond membership in most of our markets is approximately $35.00 (entitling members to two cards). A membership fee helps us offer high quality merchandise at low prices, providing value to our members. In October 2012, we launched the Platinum membership account in Costa Rica. Platinum members pay an annual membership fee of approximately $75.00 for a primary membership card for which they receive an annual 2% rebate of their purchases on most items, up to a maximum annual rebate of $500.00. Platinum members can apply this rebate to future purchases at the warehouse club at the end of the annual membership period. We continue to evaluate the Platinum membership program to determine if Platinum memberships should be offered in any of our other markets.

Logistics and distribution operations are an important part of what allows us to deliver high quality merchandise at low prices to our members. We continue to explore areas to improve efficiency, reduce costs and ensure a good flow of merchandise to our warehouse clubs. We have added local and regional distribution centers in several of our markets to improve merchandise flow and in-stock conditions and reduce operating costs, the benefit of which can be passed on to our members in the form of lower merchandise prices, and we expect to add more in fiscal year 2015 as merchandise volumes increase.

We offer on-line shopping options to our members. Members have the ability to purchase merchandise that is not stocked in their local warehouse clubs through our e-commerce website. These purchases are shipped from the U.S. distribution warehouse for pick-up at the member's local warehouse club location. In Colombia, members can purchase in-club merchandise on-line from warehouse clubs located within Colombia and have it delivered to their home or office via a third-party delivery service. We have been expanding our offerings in these alternative shopping methods, and while the percentage of sales through these channels relative to our overall sales is small, we believe it is an important and growing way to serve our current members and attract new members.

Purchasing land and constructing warehouse clubs is our single largest capital investment. Securing land for warehouse club locations is challenging within our markets, especially in Colombia, because suitable sites at economically feasible prices are difficult to find. In September 2014, we acquired land in La Chorrera ("Costa

Verde"), west of Panama City, Panama, on which our fifth PriceSmart warehouse club in Panama is scheduled to open in the summer of 2015. While our preference is to own rather than lease real estate, we have entered into real estate leases in certain cases (most recently our Bogota, Colombia site) and will likely do so in the future. Real estate ownership provides a number of advantages as compared to leasing, including lower operating expenses, flexibility to expand or otherwise enhance our buildings, long-term control over the use of the property and the residual value that the real estate may have in future years. In order to secure warehouse club locations, we occasionally have purchased more land than is actually needed for the warehouse club facility. To the extent that we acquire property in excess of what is needed for a particular warehouse club, we generally have looked to either sell or develop the excess property. Excess land at Alajuela and Brisas is being developed by joint ventures formed by us and the sellers of the property, which commenced in fiscal year 2011. We are employing a similar development strategy for the excess land at the San Fernando, Trinidad and Arroyo Hondo, Dominican Republic locations where the properties are fully owned by us. The recent land purchases in Pereira and Medellin, Colombia, and La Chorrera, Panama do not contain excess property beyond that which will be needed for warehouse clubs. The profitable sale or development of real estate is highly dependent on real estate market conditions.

The rapid devaluation of the Colombia peso during the past four months, especially compared to the US dollar, increases the cost of imported merchandise purchased by Pricesmart Colombia. These higher costs result in higher prices for our Colombia members and a lower rate of sales for imported products. We are taking steps to minimize the price increases and resulting impact on demand on imported items by (1) seeking ways to further reduce costs throughout the supply chain; (2) reducing our mark-ups (margins) for these items; and (3) continuing to offer value and merchandise differentiation to our members. Keeping the long term growth of Pricesmart in Colombia as our highest priority, we are prepared to accept lower merchandise margins and profits in Colombia in order to solidify our market position for the future. We are encouraged by the fact that membership sign ups at our Colombia clubs continue to be strong and by the good growth in transactions and local currency denominated sales.

Financial highlights for the second quarter of fiscal year 2015 included:

- Net warehouse club sales increased 11.4% over the comparable prior year period. We ended the quarter with 36 warehouse clubs compared to 32 warehouse clubs at the end of the second quarter of fiscal year 2014. Comparable warehouse club sales (that is, sales in the warehouse clubs that have been open for greater than 13 1/2 calendar months) for the 13 weeks ended February 28, 2015 grew 1.4%.
- Membership income for the second quarter of fiscal year 2015 increased 14.9% to $10.9 million.
- Warehouse gross profits (net warehouse club sales less associated cost of goods sold) in the quarter increased 11.2% over the prior year period and warehouse gross profits as a percent of net warehouse club sales were 14.5%, a decrease of 2 basis points (0.02%) from the same period last year.
- Operating income for the second quarter of fiscal year 2015 was $41.7 million, an increase of $2.3 million over the second quarter of fiscal year 2014.
- We had a $(1.7) million net loss from currency exchange transactions in the current quarter compared to a $712,000 net gain from currency exchange transactions in the same period last year.
- Net income for the second quarter of fiscal year 2015 was $24.8 million, or $0.82 per diluted share, compared to $28.3 million, or $0.93 per diluted share, in the comparable prior year period.

Net income for the second quarter of fiscal year 2015 was $0.82 per share, a decline of $0.11 per share from the second quarter of fiscal year 2014. While many of our markets performed well in the quarter, the reduction in net income can be attributed to Colombia where various factors, most notably the devaluation of the Colombian peso, led to a year on year reduction of net income and negatively impacted the consolidated results of the Company by approximately $0.16 per share. The rest of the Company performed well in the quarter with growth in sales and membership income, and higher operating profit; contributing additional net income of approximately $0.05 per share to the consolidated results compared to the second quarter of last year.

In Colombia, the effect of the currency devaluation of the Colombian peso compared to the U.S. dollar impacted sales when reported in U.S. dollars and caused prices of imported products to increase in local currency terms thereby impacting consumer demand for those products. We reduced our merchandise margins by 258 basis points (2.58%) compared to last year largely in response to the cost increase on imported merchandise in order to pass on further value to our members during this time of currency volatility. Also related to the peso devaluation, we incurred an approximately $1.8 million second quarter currency loss in Colombia compared to approximately a $139,000 loss last year. Finally, a newly instituted corporate tax on equity affecting all Colombian companies resulted in a full calendar year's expense of approximately $846,000 being recognized in the current quarter. We view these current challenging and unfavorable conditions to not be reflective of the long term prospects for PriceSmart in Colombia. Colombia has the highest growth opportunities of any of our current markets. We intend to continue to look for opportunities and expand our business over the coming months and years in Colombia.

COMPARISON OF THE THREE AND SIX MONTHS ENDED FEBRUARY 28, 2015 AND 2014

The following discussion and analysis compares the results of operations for the three-month and six-month periods ended on February 28, 2015 with the three-month and six-month periods ended on February 28, 2014 and should be read in conjunction with the consolidated financial statements and the accompanying notes included elsewhere in this report. Unless otherwise noted, all tables present U.S. dollar amounts in thousands. Certain percentages presented are calculated using actual results prior to rounding.

Net Warehouse Club Sales

| | Three Months Ended February 28, | | Six Months Ended February 28, | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | 2015 | | 2014 |
| | Amount | % Change | Amount | Amount | % Change | Amount |
| Net warehouse club sales | $732,120 | 11.4 % | $657,167 | $1,368,535 | 9.8 % | $1,246,861 |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

Growth in net warehouse club sales for the second quarter of fiscal year 2015 was positively impacted by the addition of three new warehouse clubs in Colombia and one in Honduras. Overall, Colombia accounted for nearly 60% of the dollar growth in net warehouse sales of the Company despite the negative impact of the year on year Colombian peso devaluation of approximately 22%. Honduras, with the additional warehouse club, and Panama each recorded growth in excess of 10% in the quarter compared to last year. Other strong growth countries included Guatemala, Trinidad, and Nicaragua. Year on year warehouse sales growth in Costa Rica continued to be impacted by unfavorable currency comparisons to last year when measured in U.S. dollars. Net warehouse sales growth in the second quarter of fiscal year 2015 resulted from an 11.5% increase in transactions and a 0.1% decrease in average ticket, which was impacted by local currency sales converted back to fewer U.S. dollars in Colombia, Costa Rica, Honduras, Jamaica, and the Dominican Republic.

Net warehouse sales for the six months ended February 28, 2015 increased 9.8%. The higher growth in sales in the three month period compared to the six month period reflects the full quarter effect of the new Colombian warehouse clubs which opened in October and November 2014. For the six month period, transactions grew 8.5% and the average ticket grew 1.2%.

Comparable Sales

We report comparable warehouse club sales on a “same week” basis with 13 weeks in each quarter beginning on a Monday and ending on a Sunday. The periods are established at the beginning of the fiscal year to provide as close a match as possible to the calendar month and quarter that is used for financial reporting purposes. This approach equalizes the number of weekend days and weekdays in each period for improved sales comparison, as we experience higher warehouse club sales on the weekends. Further, each of the warehouse clubs used in the calculations was open for at least 13 1/2 calendar months before its results for the current period were compared with its results for the prior period. For example, the sales related to the warehouse club opened in La Union, Cartago, Costa Rica ("Tres Rios") on October 18, 2013 were not included in the calculation of comparable warehouse sales until January 2015. Sales related to the warehouse club opened in Tegucigalpa, Honduras ("El Sauce") on May 1, 2014 will not be used in the calculation of comparable warehouse club sales until July 2015. Sales related to the warehouse club opened in Bogota, Colombia on October 29, 2014 will not be used in the calculation of comparable sales until January 2016. Sales related to the warehouse clubs opened in Pereira and Medellin, Colombia on November 13, 2014 and November 26, 2014, respectively, will not be used in the calculation of comparable sales until January and February 2016, respectively.

Comparison of Three and Six Months Ended February 28, 2015 and 2014

Comparable warehouse club sales increased 1.4% for the 13-week period ended February 28, 2015, compared to the same 13-week period last year. We opened a new warehouse club in Tegucigalpa, Honduras in May 2014. This new warehouse club is attracting new members from areas of the city not previously served by us. However, it is also creating the opportunity for some existing members, particularly those who shopped at our first Tegucigalpa, Honduras warehouse club, to shop at the new location. This transfer of sales from an existing warehouse club that is included in the calculation of comparable warehouse club sales to a new warehouse club that is not included in the

calculation has an adverse impact on comparable warehouse club sales. We have not made a specific determination of what the comparable warehouse club sales would have been had we not opened this new warehouse club. However, if we exclude in its entirety the net warehouse sales of the pre-existing Tegucigalpa warehouse club (which is in the comparable warehouse club calculation, but was negatively impacted by the opening of the new warehouse club in Tegucigalpa), the comparable warehouse club sales for the quarter would have been approximately 84 basis points (0.84%) higher. Although there is some impact to our first three warehouse clubs in Colombia from the opening of the three new clubs in Colombia, particularly Bogota, it is too soon to accurately determine that specific impact given other factors affecting the year on year comparisons of the first three warehouse clubs, most notably the currency devaluation.

Comparable warehouse club sales increased 1.7% for the 26-week period ended February 28, 2015, compared to the same 26-week period last year.

Net Warehouse Club Sales by Segments

The following tables indicate the net warehouse club sales by segment in the segments which we operate, and the percentage growth in net warehouse club sales by segment during the three and six months ended February 28, 2015 and 2014.

During the first quarter of fiscal 2014, we opened our sixth membership warehouse club in Costa Rica in La Union, Cartago, and in the third quarter of fiscal year 2014, we opened our third warehouse club in Honduras. During the first quarter of fiscal year 2015, we opened three additional warehouse clubs in Colombia (Bogota, Pereira and Medellin) bringing the total warehouse clubs in Colombia to six.

| | Three Months Ended February 28, 2015 | | | | | | 2014 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Amount | % of net sales | | Increase from prior year | Change | | Amount | % of net sales | |
| Central America | $418,952 | 57.2 | % | $22,616 | 5.7 | % | $396,336 | 60.3 | % |
| Caribbean | 217,293 | 29.7 | % | 7,713 | 3.7 | % | 209,580 | 31.9 | % |
| Colombia | $95,875 | 13.1 | % | $44,623 | 87.1 | % | $51,252 | 7.8 | % |
| Net warehouse club sales | $732,120 | 100.0 | % | $74,952 | 11.4 | % | $657,168 | 100.0 | % |

| | Six Months Ended February 28, 2015 | | | | | | 2014 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Amount | % of net sales | | Increase from prior year | Change | | Amount | % of net sales | |
| Central America | $795,005 | 58.1 | % | $45,713 | 6.1 | % | $749,292 | 60.1 | % |
| Caribbean | 412,865 | 30.2 | % | 13,957 | 3.5 | % | 398,908 | 32.0 | % |
| Colombia | $160,665 | 11.7 | % | $62,004 | 62.8 | % | $98,661 | 7.9 | % |
| Net warehouse club sales | $1,368,535 | 100.0 | % | $121,674 | 9.8 | % | $1,246,861 | 100.0 | % |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

For the three and six months ended February 28, 2015 and 2014, sales growth in Central America compared to the Caribbean primarily reflects the sales associated with the additional warehouse club sales in La Union, Costa Rica and Tegucigalpa, Honduras and the higher net warehouse club sales growth in Colombia reflects the sales associated with the three Colombia warehouse clubs opened during the quarter. We expect Colombia and Central America sales growth to continue to outpace Caribbean sales growth because of the opening of the three new warehouse clubs in Colombia and because the next warehouse club we expect to open is in Panama.

Export Sales

| | Three Months Ended February 28, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2015 | | | | | | 2014 | | |
| | Amount | % of net sales | | (Decrease) from prior year | Change | | Amount | % of net sales | |
| Export sales | 6,229 | 0.9 | % | $ (535 ) | (7.9 | )% | 6,764 | 1.0 | % |

| | Six Months Ended February 28, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2015 | | | | | | 2014 | | |
| | Amount | % of net sales | | Increase from prior year | Change | | Amount | % of net sales | |
| Export sales | $ 14,660 | 1.1 | % | $ 2,175 | 17.4 | % | $ 12,485 | 1.0 | % |

Export sales are direct sales to a single institutional customer (retailer) in the Philippines for which we earn an approximate 5% margin. Changes in the activity in the current quarter and the six months ended February 28, 2015 compared to the prior year periods reflects changes in the merchandise needs of that retailer's business.

Membership Income

| | Three Months Ended February 28, | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2015 | | | | | 2014 | |
| | Amount | | Increase from prior year | % Change | | Amount | |
| Membership income | $ 10,898 | | $ 1,417 | 14.9 | % | $ 9,481 | |
| Membership income % to net warehouse club sales | 1.5 | % | | | | 1.4 | % |
| Number of total accounts | 1,380,182 | | 231,243 | 20.1 | % | 1,148,939 | |

| | Six Months Ended February 28, | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2015 | | | | | 2014 | |
| | Amount | | Increase from prior year | % Change | | Amount | |
| Membership income | $ 21,013 | | $ 2,264 | 12.1 | % | $ 18,749 | |
| Membership income % to net warehouse club sales | 1.5 | % | | | | 1.5 | % |
| Number of total accounts | 1,380,182 | | 231,243 | 20.1 | % | 1,148,939 | |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

Membership income is recognized ratably over the one year life of the membership. The increase in membership income primarily reflects a growth in membership accounts during the last twelve months. The opening of the new warehouse clubs in Colombia accounted for over 60% of the total increase in member accounts from a year ago. The average number of member accounts during the quarter increased 18.9% compared to the average number of membership accounts in the second quarter of fiscal year 2014. The income recognized per average member account decreased 3.2%, which reflects the effect of the impact of devaluation in Colombia on the translation of membership fees in local currency to U.S. dollars. In Colombia, the membership is priced in Colombian pesos. We have not raised the fee despite the recent devaluation given that we just opened three new warehouse clubs. We ended the fiscal quarter with a renewal rate of 85% for the twelve-month period ended February 28, 2015.

For the six months ended February 28, 2015, the increase in membership income reflects a growth in membership accounts offset somewhat by a decrease in the average fee collected for new and renewing members, primarily associated with the significant growth of members in Colombia who pay a lower membership fee in U.S. dollar equivalents due to the peso devaluation.

Other Income

| | Three Months Ended February 28, 2015 | | | | 2014 |
|---|---|---|---|---|---|
| | Amount | Increase from prior year | % Change | | Amount |
| Other income | $1,049 | $87 | 9.0 | % | $962 |

| | Six Months Ended February 28, 2015 | | | | 2014 |
|---|---|---|---|---|---|
| | Amount | Increase from prior year | % Change | | Amount |
| Other income | $2,109 | $229 | 12.2 | % | $1,880 |

Other income consists of rental income, advertising revenue and other miscellaneous revenue, with the year-over-year increase coming largely from higher rental income.

Gross Margin

Warehouse Gross Profit Margin

| | Three Months Ended February 28, 2015 | | | | 2014 | | |
|---|---|---|---|---|---|---|---|
| | Amount | Increase from prior year | % to sales | | Amount | % to sales | |
| Warehouse club sales | $732,120 | $74,953 | 100.0 | % | $657,167 | 100.0 | % |
| Less associated cost of goods | 625,876 | 64,224 | 85.5 | % | 561,652 | 85.5 | % |
| Warehouse gross profit margin | $106,244 | $10,729 | 14.5 | % | $95,515 | 14.5 | % |

| | Six Months Ended February 28, 2015 | | | | 2014 | | |
|---|---|---|---|---|---|---|---|
| | Amount | Increase from prior year | % to sales | | Amount | % to sales | |
| Warehouse club sales | $1,368,535 | $121,674 | 100.0 | % | $1,246,861 | 100.0 | % |
| Less associated cost of goods | 1,164,904 | 98,965 | 85.1 | % | 1,065,939 | 85.5 | % |
| Warehouse gross profit margin | $203,631 | $22,709 | 14.9 | % | $180,922 | 14.5 | % |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

For the three months ended February 28, 2015, warehouse gross profit margin as a percent of sales was 2 basis points (0.02%) lower than the three months ended February 28, 2014. Warehouse gross profit margin as a percent of sales decreased 258 basis points (2.58%) in Colombia from the year ago period largely as a result of actions we took to reduce the impact of higher prices on imported goods to our members. Overall, this negatively impacted the Company's margin by 33 basis points (0.33%). We will continue to lower prices and set aggressive margins to provide our members in Colombia with value on imported merchandise during this period of currency volatility. Warehouse gross profit margins as a percent of sales in the non-Colombia markets were in aggregate 46 basis points (0.46%) higher than the same quarter a year ago on a higher level of product demonstration activity and vendor rebates.

For the six months ended February 28, 2015, warehouse gross profit margin as a percent of sales was 37 basis points (0.37%) higher than the six months ended February 28, 2014. In the first fiscal quarter we benefited from lower costs

as a percent of sales in a number of areas, including lower merchandise distribution costs and reduced shrink. Vendor rebates and a higher

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level of product demonstration activity also contributed to the higher gross margin in the current period compared to a year ago. This was partially offset the second fiscal quarter with lower margins in Colombia.

Export Sales Gross Profit Margin

| | Three Months Ended February 28, 2015 | | | 2014 | |
|---|---|---|---|---|---|
| | Amount | (Decrease) from prior year | % to sales | Amount | % to sales |
| Export sales | $6,229 | $(535) | 100.0 % | $6,764 | 100.0 % |
| Less associated cost of goods sold | 5,934 | (489) | 95.3 % | 6,423 | 95.0 % |
| Export sales gross profit margin | $295 | $(46) | 4.7 % | $341 | 5.0 % |

| | Six Months Ended February 28, 2015 | | | 2014 | |
|---|---|---|---|---|---|
| | Amount | Increase from prior year | % to sales | Amount | % to sales |
| Export sales | $14,660 | $2,175 | 100.0 % | $12,485 | 100.0 % |
| Less associated cost of goods sold | 13,961 | 2,097 | 95.2 % | 11,864 | 95.0 % |
| Export sales gross profit margin | $699 | $78 | 4.8 % | $621 | 5.0 % |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

For the three and six months ended February 28, 2015 and 2014, the changes in the activity in the current quarter and the six months ended February 28, 2015 compared to the prior year periods reflects changes in the merchandise needs and sales to a single institutional customer (retailer) in the Philippines for which we earn an approximate 5% margin.

Selling, General and Administrative Expenses

Warehouse Club Operations

| | Three Months Ended February 28, 2015 | | | | 2014 | |
|---|---|---|---|---|---|---|
| | Amount | % to warehouse club sales | Increase from prior year | % Change | Amount | % to warehouse club sales |
| Warehouse club operations expense | $62,041 | 8.5 % | $8,838 | 16.6 % | $53,203 | 8.1 % |

| | Six Months Ended February 28, 2015 | | | | 2014 | |
|---|---|---|---|---|---|---|
| | Amount | % to warehouse club sales | Increase from prior year | % Change | Amount | % to warehouse club sales |
| Warehouse club operations expense | $118,251 | 8.6 % | $13,276 | 12.6 % | $104,975 | 8.4 % |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

Warehouse club operations expense as a percent of net warehouse sales for the second quarter of fiscal year 2015 increased 36 basis points (0.36%) compared to the same period in fiscal 2014. Warehouse club operations expense as

a percent of sales in Colombia is higher than in the rest of the countries in which we operate, and it is becoming a larger portion of the overall Company's sales and cost structure. In addition, the implementation of an "Equity Tax" affecting all Colombian companies resulted in an additional expense of approximately $850,000 in the quarter. This is an annual expense to be recognized in the first calendar quarter based on equity values. Warehouse club operations expense in the non-Colombia countries as a percent of warehouse sales improved 11 basis points (0.11%).

Warehouse club operations expense as a percent of net warehouse sales for the first six months of fiscal year 2015 increased 21 basis points (0.21%) compared to the same period in fiscal 2014. Higher costs in Colombia, including costs associated with the registration of capital, and higher depreciation expenses contributed to the increase.

General and Administrative Expenses

| | Three Months Ended February 28, 2015 | | | | 2014 | |
|---|---|---|---|---|---|---|
| | Amount | % to warehouse club sales | Increase from prior year | % Change | Amount | % to warehouse club sales |
| General and administrative expenses | $14,117 | 1.9 % | $840 | 6.3 % | $13,277 | 2.0 % |

| | Six Months Ended February 28, 2015 | | | | 2014 | |
|---|---|---|---|---|---|---|
| | Amount | % to warehouse club sales | Increase from prior year | % Change | Amount | % to warehouse club sales |
| General and administrative expenses | $27,467 | 2.0 % | $3,006 | 12.3 % | $24,461 | 2.0 % |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

The expenses associated with our corporate and U.S. buying operations grew 6.3% in the quarter compared to last year and 12.3% for the six-month period. Spending investments in the IT and buying departments accounted for the majority of the growth.

Pre-Opening Expenses

Expenses incurred before a warehouse club is in operation are captured in pre-opening expenses.

| | Three Months Ended February 28, 2015 | | | 2014 |
|---|---|---|---|---|
| | Amount | Increase/ (decrease) from prior year | % Change | Amount |
| Pre-opening expenses | $229 | $(111 ) | (32.6 )% | $340 |

| | Six Months Ended February 28, 2015 | | | 2014 |
|---|---|---|---|---|
| | Amount | Increase/ (decrease) from prior year | % Change | Amount |
| Pre-opening expenses | $3,378 | $2,564 | 315.0 % | $814 |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

The pre-opening expenses in the quarter related to the new Panama warehouse club currently under construction with a planned opening this summer. For the six month period, and except for the small amount in the current quarter

related to Panama, pre-opening expenses were for the three Colombia warehouse clubs opened in the first fiscal quarter. During the same three-month period last year, the pre-opening expenses were associated with the leased land for the now opened Bogota club, the El Sauce, Honduras warehouse club opened May 2014, and, for the six-month period, the La Union, Cartago, Costa Rica ("Tres Rios") warehouse club opened in October 2013.

Loss/(Gain) on Disposal of Assets

Asset disposal activity consisted mainly of normally scheduled asset replacement and upgrades.

| | Three Months Ended February 28, | | | | |
|---|---|---|---|---|---|
| | 2015 | | | | 2014 |
| | Amount | Increase/ (decrease) from prior year | % Change | | Amount |
| Loss/(gain) on disposal of assets | $ 391 | $ 287 | 276.0 | % | $ 104 |

| | Six Months Ended February 28, | | | | |
|---|---|---|---|---|---|
| | 2015 | | | | 2014 |
| | Amount | Increase/ (decrease) from prior year | % Change | | Amount |
| Loss/(gain) on disposal of assets | $ 363 | $ 175 | 93.1 | % | $ 188 |

Operating Income

| | Three Months Ended February 28, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2015 | | | | | | 2014 | | |
| | Amount | % to warehouse club sales | | Increase/(decrease) from prior year | % Change | | Amount | % to warehouse club sales | |
| Operating income | 41,708 | 5.7 | % | $ 2,333 | 5.9 | % | 39,375 | 6.0 | % |

| | Six Months Ended February 28, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2015 | | | | | | 2014 | | |
| | Amount | % to warehouse club sales | | Increase/(decrease) from prior year | % Change | | Amount | % to warehouse club sales | |
| Operating income | $77,993 | 5.7 | % | $ 6,259 | 8.7 | % | $71,734 | 5.8 | % |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

For the three months ended February 28, 2015, operating income improved $2.3 million compared to the prior year period, primarily due to higher sales and membership income. As a percentage of sales, operating income decreased 29 basis points (0.29%), resulting from reduced merchandise margins and higher operating expenses in Colombia.

For the six months ended February 28, 2015, operating income improved $6.3 million compared to the prior year period, primarily due to higher sales and related merchandise margins and higher membership income. As a percentage of sales, operating income decreased 5 basis points (.05%), resulting from higher merchandise margins.

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Interest Expense

| | Three Months Ended February 28, | | |
|---|---|---|---|
| | 2015 | | 2014 |
| | Amount | Increase/(decrease) from prior year | Amount |
| Interest expense on loans | $1,403 | $ 657 | $746 |
| Interest expense related to hedging activity | 714 | 380 | 334 |
| Capitalized interest | (147) | 47 | (194) |
| Net interest expense | $1,970 | $ 1,084 | $886 |

| | Six Months Ended February 28, | | |
|---|---|---|---|
| | 2015 | | 2014 |
| | Amount | Increase/(decrease) from prior year | Amount |
| Interest expense on loans | $2,681 | $ 1,028 | $1,653 |
| Interest expense related to hedging activity | 1,226 | 462 | 764 |
| Capitalized interest | (763) | (270) | (493) |
| Net interest expense | $3,144 | $ 1,220 | $1,924 |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

Interest expense reflects borrowings by our wholly owned foreign subsidiaries to finance new warehouse club construction and land acquisition, the capital requirements of warehouse club operations and ongoing working capital requirements.

Net interest expense for the three months ended February 28, 2015 increased from a year ago, with an increase in interest expense on loans and on interest expenses related to hedging activity, partially offset by an increase in the amount of capitalized interest compared with the same period in the prior year. These changes were mainly due to the net increases in loans outstanding and hedging activities related to new loan activity.

Net interest expense for the six months ended February 28, 2015 increased from a year ago, with an increase in interest expense on loans and on interest expenses related to hedging activity, partially offset by an increase in the amount of capitalized interest compared with the same period in the prior year. These changes were mainly due to the net increases in loans outstanding, hedging activities related to new loan activity to support the increase in construction activities related to the three new warehouse clubs in Colombia.

Other Income (Expense), net

Other income consists of currency gain or loss.

| | Three Months Ended February 28, | | |
|---|---|---|---|
| | 2015 | | 2014 |
| | Amount | Increase from prior year | Amount |
| Other income (expense), net | $(1,659) | $(2,371) | $712 |

| | Six Months Ended February 28, | | |
|---|---|---|---|
| | 2015 | | 2014 |
| | Amount | Increase from prior year | Amount |
| Other income (expense), net | $(4,291) | $(5,314) | $1,023 |

Monetary assets and liabilities denominated in currencies other than the functional currency of the respective entity (primarily U.S. dollars) are revalued to the functional currency using the exchange rate on the balance sheet date. These foreign exchange transaction gain (losses), including repatriation of funds, are recorded as currency gain or losses.

Comparison of Three and Six Months Ended February 28, 2015 and 2014

For the three and six months ended February 28, 2015, we recorded a net currency loss of $1.7 million and $4.3 million, respectively, resulting from activity associated with monetary assets and liabilities, and the associated non-deliverable forwards that were in place to manage the impact of currency fluctuations. Of the total loss, $1.8 million in the current quarter and $4.1 million for the six-month period was recognized in Colombia, resulting from the devaluation of the Colombian peso relative to the U.S. dollar of 13.2% and 29.0%, respectively. The impact of this depreciation had a material impact on our consolidated results due to the high level of U.S. dollar denominated inter-company liabilities held by our Colombian subsidiary. These U.S. dollar denominated inter-company liabilities were greater than what we would expect from normal operations because of the impact of the subsidiary's initial acquisition of merchandise to stock the three new warehouse clubs opened in October and November 2014 and the investment in fixed assets for these same warehouse clubs that extended into the current quarter. As the Colombian peso continued to devalue throughout the period, settlements of these liabilities resulted in realized currency losses. Further, any remaining liabilities at the end of the period were subject to revaluation at a higher exchange rate relative to the U.S. dollar. While a significant portion of this exposure was covered by non-deliverable forward contracts, there was a net negative impact to income related to the devaluation in Colombia in the period. Other subsidiaries that had greater U.S. dollar denominated cash and cash equivalents (including restricted cash) than their U.S. dollar denominated liabilities did not experience similar depreciation in their markets and therefore did not counterbalance the impact of the depreciation in Colombia. Although we cannot predict future changes in exchange rates, we believe that we will be less susceptible to such fluctuations in future periods because the Colombia subsidiary's U.S. dollar denominated inter-company liabilities have been paid down to a normalized level.

In the prior three- and six-month periods, we recorded a net currency gain of $712,000 and $1.0 million, respectively. While Colombia incurred a net currency loss of $127,000 in the six month period last year, currency gains were recorded in several countries, most notably Costa Rica, relating to a net U.S. dollar asset position held at a time when the colon devalued thereby resulting in a revaluation gain.

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Provision for Income Taxes

| | Three Months Ended February 28, | | | | |
|---|---|---|---|---|---|
| | 2015 | | | 2014 | |
| | Amount | | Change from prior year | Amount | |
| Current tax expense | $13,654 | | $1,294 | $12,360 | |
| Net deferred tax provision (benefit) | (128 | ) | 1,116 | (1,244 | ) |
| Provision for income taxes | $13,526 | | $2,410 | $11,116 | |
| Effective tax rate | 35.3 | % | | 28.2 | % |

| | Six Months Ended February 28, | | | | |
|---|---|---|---|---|---|
| | 2015 | | | 2014 | |
| | Amount | | Change from prior year | Amount | |
| Current tax expense | $23,150 | | 1,013 | $22,137 | |
| Net deferred tax provision (benefit) | 2,478 | | 3,114 | (636 | ) |
| Provision for income taxes | $25,628 | | $4,127 | $21,501 | |
| Effective tax rate | 36.1 | % | | 30.2 | % |

Comparison of Three and Six Months Ended February 28, 2015 and 2014

The variance in the effective tax rate for the three-month period ended on February 28, 2015 compared to the same period of the prior year was primarily attributable to the unfavorable impact of 4.2% resulting from an increased taxable loss incurred in the Company's Colombia subsidiary for which no tax benefit was recognized net of adjustment to valuation allowance and the non-recurrence of a favorable impact of 2.0% in the prior period from the tax effect of changes in foreign currency value.

The variance in the effective tax rate for the six month period ended February 28, 2015 compared to the prior year was primarily attributable to the unfavorable impact of 4.7% resulting from an increased taxable loss incurred in the Company's Colombia subsidiary for which no tax benefit was recognized net of adjustment to valuation allowance and the non-recurrence of a favorable impact of 1.1% in the prior period from the tax effect of changes in foreign currency value.

Other Comprehensive Income (Loss)

| | Three Months Ended February 28, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015 | | | | | | 2014 | |
| | Amount | | Increase/(decrease) from prior year | | % Change | | Amount | |
| Other comprehensive income (loss) | $(9,694 | ) | $2,894 | | (23.0 | )% | $(12,588 | ) |

| | Six Months Ended February 28, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015 | | | | | | 2014 | |
| | Amount | | Increase/(decrease) from prior year | | % Change | | Amount | |
| Other comprehensive income (loss) | $(19,113 | ) | $(7,674 | ) | 67.1 | % | $(11,439 | ) |

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Comparison of Three and Six Months Ended February 28, 2015 and 2014

Other comprehensive income/loss for the three- and six-month periods ended February 28, 2015 and 2014 resulted primarily from foreign currency translation adjustments of the balance sheet, related to the assets, liabilities and the translation of the statement of income related to revenue, costs and expenses of our subsidiaries who's functional currency is not the U.S. dollar. When the functional currency in our international subsidiaries is the local currency and not U.S. dollars, the assets and liabilities of such subsidiaries are translated to U.S. dollars at the exchange rate on the balance sheet date, and revenue, costs and expenses are translated at average rates of exchange in effect during the period. The corresponding translation gains and losses are recorded as a component of accumulated other comprehensive income or loss. These adjustments will not affect net income until the sale or liquidation of the underlying investment. The reported other comprehensive income or loss reflects the unrealized increase or decrease in the value in U.S. dollars of the net assets of the subsidiaries as of the date of the balance sheet, which will vary from period to period as exchange rates fluctuate. During the periods reported, the largest translation adjustments were related to the translation of the Colombia subsidiary's balance sheet and statement of income. Additionally, the recording of the unrealized gains (losses) on change in fair value of interest rate swaps also generated adjustments.

For the three months ended February 28, 2015, the Company recorded approximately $10.9 million in other comprehensive losses due to foreign currency translations and approximately $1.2 million, net of tax, of other comprehensive gains related to the change in fair value of interest rate swaps. For the six months ended February 28, 2015, the Company recorded approximately $22.6 million in other comprehensive losses due to foreign currency translations and approximately $3.5 million, net of tax, of other comprehensive gains related to the change in fair value of interest rate swaps.

LIQUIDITY AND CAPITAL RESOURCES

Financial Position and Cash Flow

We require cash to fund our operating expenses and working capital requirements, including the investment in merchandise inventories, acquisition of land and construction of new warehouse clubs, expansion of existing warehouse clubs and distribution centers, acquisitions of fixtures and equipment, routine upgrades and maintenance of fixtures and equipment within existing warehouse clubs, investments in joint ventures in Panama and Costa Rica to own and operate commercial retail centers located adjacent to the new warehouse clubs, the purchase of treasury stock upon the vesting of restricted stock awards and payment of dividends to stockholders. Our primary sources for funding these requirements are cash and cash equivalents on hand, cash generated from operations and bank borrowings. We evaluate on a regular basis whether we may need to borrow additional funds to cover any shortfall in our ability to generate sufficient cash from operations to meet our operating and capital requirements. As such, we may enter into or obtain additional loans and/or credit facilities to provide additional liquidity when necessary.

The following table summarizes the cash and cash equivalents held by our foreign subsidiaries and domestically (in thousands). Repatriation of cash and cash equivalents held by foreign subsidiaries may require us to accrue and pay taxes. We have no plans at this time to repatriate cash through the payment of cash dividends by our foreign subsidiaries to our domestic operations and, therefore, have not accrued taxes that would be due from repatriation.

| | February 28, 2015 | August 31, 2014 |
|---|---|---|
| Cash and cash equivalents held by foreign subsidiaries | $106,492 | $110,447 |
| Cash and cash equivalents held domestically | 12,751 | 26,651 |
| Total cash and cash equivalents | $119,243 | $137,098 |

Our cash flows are summarized as follows (in thousands):

| | Six Months Ended | |
|---|---|---|
| | February 28, 2015 | February 28, 2014 |
| Net cash provided by (used in) operating activities | $11,944 | $35,710 |
| Net cash provided by (used in) investing activities | (43,828) | (59,654) |
| Net cash provided by (used in) financing activities | 14,210 | (17,667) |
| Effect of exchange rates | (181) | (4,926) |
| Net increase (decrease) in cash and cash equivalents | $(17,855) | $(46,537) |

Our net cash provided by (used in) operating activities for the six months ended February 28, 2015 and 2014 is summarized below:

| | Six Months Ended | | Increase/ (Decrease) |
|---|---|---|---|
| | February 28, 2015 | February 28, 2014 | 2015 to 2014 |
| Net income | $45,482 | $49,710 | $(4,228) |
| Adjustments to reconcile net income to net cash provided from (used in) operating activities: | | | |
| Depreciation and amortization | 16,433 | 13,793 | 2,640 |
| (Gain) loss on sale of property and equipment | 363 | 188 | 175 |
| Deferred income taxes | 2,478 | 1,857 | 621 |
| Stock-based compensation expenses | 1,883 | 1,976 | (93) |
| Other non-cash operating activities | (17) | 2 | (19) |
| Net non-cash related expenses | 21,140 | 17,816 | 3,324 |
| Net income from operating activities reconciled for non-cash operating activities | 66,622 | 67,526 | (904) |
| Changes in operating assets and liabilities not including merchandise inventories and accounts payable | (7,836) | (12,839) | 5,003 |
| Changes in merchandise inventories | (54,873) | (19,058) | (35,815) |
| Changes in accounts payable | 8,031 | 81 | 7,950 |
| Net cash provided by (used in) operating activities | $11,944 | $35,710 | $(23,766) |

Net income from operating activities reconciled for non-cash operating activities decreased $(904,000) for the six months ended February 28, 2015 over the same period last year. This was primarily a result of a a year-on-year decrease in net income of approximately $4.2 million, as explained within the comparison of the six months ended February 28, 2015, offset by increases in non-cash adjustments of approximately $3.3 million. Increase in non-cash adjustments were primarily driven by increases in depreciation expense for approximately $2.6 million due to the recent increase in the number of warehouse clubs and the continued ongoing capital improvements to existing warehouse clubs and increases in deferred tax assets during the period for approximately $621,000 resulting from temporary tax timing differences. Changes in operating assets and liabilities not including merchandise generated additional cash from operating activities for approximately $13.0 million. This was primarily a result of the year-on-year increase in trade accounts payable for approximately $8.0 million. As we increased inventory purchases related to the addition of three warehouse clubs opened during the first quarter of fiscal year 2015, and the addition of one warehouse club opened in May of fiscal year 2014, we also increased our leveraging of vendor payment terms, increasing trade accounts receivable. Additionally, we decreased year on year operating assets and liabilities not including accounts payable for approximately $5.0 million. This was a result of our decreases in the growth rate of prepaid expenses and the increase in the growth rate of other current liabilities and deferred membership income. Inventories increased year-on-year by approximately $35.8 million as we added year-on-year four additional warehouse clubs and have increased sales within our existing warehouse clubs.

Our use of cash in investing activities for the six months ended February 28, 2015 and 2014 is summarized below:

| | Six Months Ended | | Increase/ (Decrease) |
|---|---|---|---|
| | February 28, 2015 | February 28, 2014 | 2015 to 2014 |
| Cash used for additions of property and equipment: | | | |
| Land acquisitions | $5,599 | $17,415 | $(11,816) |
| Deposits for land purchase option agreements | 348 | 850 | (502) |
| Warehouse club expansion, construction, and land improvements | 21,264 | 19,263 | 2,001 |
| Acquisition of fixtures and equipment | 15,297 | 21,418 | (6,121) |
| Proceeds from disposals of property and equipment | (40) | (42) | 2 |
| Capital contribution to joint ventures | 1,360 | 750 | 610 |
| Net cash flows used by (provided in) investing activities | $43,828 | $59,654 | $(15,826) |

Net cash used in investing activities decreased in the first six months of fiscal year 2015 compared to fiscal year 2014 by approximately $(15.8) million primarily due to a decrease in cash expended for the purchase of land compared to a year ago. During fiscal year 2014, we purchased land for the construction of warehouse clubs in Pereira, Colombia and in the city of Medellin, Colombia. During the first six months of fiscal year 2015, we acquired one new site in Panama City, Panama ("La Chorrera", Costa Verde).

Expenditures for warehouse club expansions and for fixtures and equipment were associated with the construction of the three completed warehouse clubs in Colombia and the warehouse club currently under construction in Panama as well as normal ongoing capital expenditures for ongoing replacement of equipment and building and leasehold improvements. We incur approximately $30.0 million annually in normal capital expenditures for ongoing replacement of equipment and building and leasehold improvements. We have either commitments or plans for capital spending during the remainder of fiscal year 2015 for a previously announced new warehouse club construction of approximately $4.5 million. Future additional capital expenditures will be dependent on the timing of future land purchases and/or warehouse club construction activity.

We have entered into land purchase option agreements that have not been recorded as commitments as of February 28, 2015 for which we have recorded within the balance sheet approximately $1.6 million in restricted cash deposits and prepaid expenses. The land purchase option agreements can be canceled at our sole option with the amounts deposited subject to forfeiture. We do not have a timetable of when or if we will exercise these land purchase options because they remain subject to our due diligence review. Our due diligence review includes evaluations of the legal status of the property, the zoning and permitting issues related to acquiring approval for the construction and operation of a warehouse club and any other issues related to the property itself that could render the property unsuitable or limit the property's economic viability as a warehouse club site. If the purchase option agreements are all exercised, the cash use would be approximately $21.4 million.

Net cash provided, (used in) financing activities for the six months ended February 28, 2015 and 2014 is summarized below:

| | Six Months Ended | | Increase/ (Decrease) |
|---|---|---|---|
| | February 28, 2015 | February 28, 2014 | 2015 to 2014 |
| New bank loans offset by establishment of certificates of deposit held against loans and payments on existing bank loans (loan activities) | $27,709 | $(4,012) | $31,721 |
| Cash dividend payments | (10,564) | (10,570) | 6 |

| | | | |
|---|---|---|---|
| Proceeds from exercise of stock options and the tax benefit related to stock options | 1,506 | 1,463 | 43 |
| Purchase of treasury stock related to vesting of restricted stock | (4,441) | (4,548) | 107 |
| Net cash provided by (used in) financing activities | $14,210 | $(17,667) | $31,877 |

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Net cash provided by loan activities increased approximately $31.7 million over the same period in fiscal year 2014 as we received cash from four additional loans entered into by our Panama, Honduras, Trinidad and Colombia subsidiaries for approximately $10.0 million, $8.3 million, $3.6 million and $15.0 million respectively. We received additional cash from increases in short term borrowings within our Colombia subsidiary for approximately $4.5 million. Additionally, $2.9 million in restricted cash was released back to us due to the repayment of one of the loans within our Honduras subsidiary. These increases were offset by repayments of long-term loans of approximately $3.3 million and $5.0 million by our Honduras subsidiary and $3.2 million by our Trinidad subsidiary, and regularly scheduled loan payments of $5.1 million. For the same period last year, we decreased borrowings by the repayment of a long-term loan of approximately $8.1 million under the loan agreement entered into by our Colombia subsidiary on November 1, 2010 with Citibank, N.A. in New York and regularly scheduled loan payments during the period of approximately $3.9 million. These uses of cash in financing activities were offset by the addition of cash provided by financing activities from the release of approximately $8.0 million in restricted cash upon repayment of the long-term loan in Colombia.

Dividends were declared by the Company's Board of Directors during the first six months of fiscal year 2015. The following table summarizes the dividends declared and paid during fiscal year 2015 and 2014.

| | | First Payment | | | | Second Payment | | | |
|---|---|---|---|---|---|---|---|---|---|
| Declared | Amount | Record Date | Date Paid | Date Payable | Amount | Record Date | Date Paid | Date Payable | Amount |
| 2/4/15 | $ 0.70 | 2/13/15 | 2/27/15 | N/A | $ 0.35 | 8/14/15 | N/A | 8/31/15 | $ 0.35 |
| 1/23/14 | $ 0.70 | 2/14/14 | 2/28/14 | N/A | $ 0.35 | 8/15/14 | 8/29/14 | N/A | $ 0.35 |

We anticipate the ongoing payment of semi-annual dividends in subsequent periods, although the actual declaration of future dividends, the amount of such dividends, and the establishment of record and payment dates is subject to final determination by the Board of Directors at its discretion after its review of the Company’s financial performance and anticipated capital requirements.

Financing Activities

On February 18, 2015 the Company's Honduras subsidiary paid down a loan entered into in March 2010. The loan agreement was with Banco Del Pais, S.A. for a loan based in Honduran Lempiras that was equivalent to approximately U.S. $6.0 million, which was scheduled to be paid over five years. The Company’s Honduras subsidiary also had an agreement with Banco Del Pais to open and maintain a certificate of deposit as collateral for this loan. The certificate of deposit was automatically renewable by Banco Del Pais on an annual basis for the net amortized outstanding balance. The net amortized outstanding balance for the loan on the date of the loan pay down was approximately $87,000. The certificate of deposit released at the date of payment was approximately $2.9 million.

On January 29, 2015, the Company's Trinidad subsidiary entered into a loan agreement with Citibank, Limited. The agreement establishes a credit facility for $23.0 million Trinidad and Tobago Dollars (approximately $3.6 million U.S. dollars) with a fixed interest rate of 4.45%. The loan term is for four years with monthly interest and quarterly principal payments. The loan was funded on February 18, 2015.

On December 4, 2014, the Company's Colombia subsidiary entered into a loan agreement with Citibank, N.A. The agreement establishes a credit facility for $15.0 million with a variable interest rate of three-month LIBOR plus 2.8%. The loan term is for five years with quarterly interest and principal payments. The loan was funded on December 4, 2014. On December 10, 2014, the Company's Colombia subsidiary entered into a cross-currency interest rate swap agreement with Citibank, N.A for a notional amount of $15.0 million related to this loan. The cross-currency interest rate swap agreement converts the Colombian subsidiary's U.S. dollar denominated principal and floating interest payments on the first $7.9 million of the total $15.0 million long-term quarterly amortizing debt with Citibank to

functional currency principal and fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of principal and interest payments, the hedge is intended to offset changes in cash flows attributable to interest rate and foreign exchange movements. Under the cross-currency interest rate swap agreement, the Company will receive variable U.S. dollar principal and interest based on the three-month LIBOR rate plus 2.8% on a quarterly amortizing notional amount of $15.0 million and pay fixed interest of 8.25% on a quarterly amortizing notional amount of 34,350,000,000 Colombian Pesos for a term of approximately five years (effective date of December 4, 2014 through December 3, 2019). The LIBOR reset dates for the hedged long-term debt and the cross-currency interest rate swap occur on the fourth day of March, June, September, and December beginning on March 4, 2015.

On November 28, 2014, our Panama subsidiary drew down the final $10.0 million available against the credit facility established on March 31, 2014 under a loan agreement with The Bank of Nova Scotia. That agreement established a credit facility of $34.0 million at a variable interest rate of 30-day LIBOR plus 3.5% for a five year term, monthly principal and interest payments, and a $17.0 million principal payment due at maturity. The facility provides a five year renewal option upon approval of the Bank of Nova Scotia. The loan is secured by assets of our Panama subsidiary. During April 2014, we drew down $24.0 million of the $34.0 million facility and repaid borrowings due to MetroBank, S.A. of $3.2 million. On December 9, 2014, the Company's Panama subsidiary entered into an interest rate swap agreement with the Bank of Nova Scotia for a notional amount of $10.0 million related to this loan. The interest rate swap agreement converts the Panama subsidiary's floating interest payments on the first $5.0 million of the total $10.0 million long-term monthly amortizing debt with the Bank of Nova Scotia to fixed interest payments during the life of the hedging instrument. As changes in interest rates impact the future cash flows of loan interest payments, the hedge is intended to offset changes in cash flows attributable to variable interest rate movements. Under the interest rate swap agreement, the Company will receive variable interest based on the 30-day LIBOR rate plus 3.5% on a monthly amortizing notional amount of $10.0 million and pay fixed interest of 5.159% for a term of approximately five years (effective date of November 28, 2014 through November 29, 2019). The LIBOR reset dates for the hedged long-term debt and the interest rate swap occur on the 28th day of each month beginning on December 29, 2014.
On October 22, 2014, our Honduras subsidiary entered into a loan agreement with Citibank, N.A. The agreement establishes a credit facility for $5.0 million with a variable interest rate of three-month LIBOR plus 3.5%. The loan term is for five years with quarterly interest and principal payments. This loan is secured by assets of the Company's Honduras subsidiary. On October 23, 2014, the Company's Honduras subsidiary entered into a cross-currency interest rate swap agreement with Citibank, N.A for a notional amount of $5.0 million. The cross-currency interest rate swap agreement converts the Honduras subsidiary foreign currency United States dollar denominated principal and floating interest payments on the first $3.0 million of the total $5.0 million long-term quarterly amortizing debt with Citibank to functional currency principal and fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of principal and interest payments, the hedge is intended to offset changes in cash flows attributable to interest rate and foreign exchange movements. Under the cross-currency interest rate swap agreement, the Company will receive variable U.S. dollar principal and interest based on the three-month LIBOR rate plus 3.5% on a quarterly amortizing notional amount of USD $5.0 million and pay fixed interest of 11.6% on a quarterly amortizing notional amount of 106,576,000 Honduran Lempiras for a term of approximately three years (effective date of October 22, 2014 through October 22, 2017). The LIBOR reset dates for the hedged long-term debt and the cross-currency interest rate swap occur on the twenty second day of January, April, July, and October, beginning on January 22, 2015. The loan was funded at execution.

On October 3, 2014, our Honduras subsidiary paid down $3.2 million of the loan agreement entered into by the subsidiary on January 12, 2010 with Scotiabank El Salvador, S.A. The original agreement established a loan facility for $6.0 million. The interest rate was fixed at 5.5%. The loan term was for five years with monthly interest and principal payment. The loan facility was renewable for an additional five-year period upon approval of Scotiabank El Salvador, S.A. The subsidiary has paid down this loan, and this loan facility has terminated.

On October 1, 2014, our Honduras subsidiary entered into a loan agreement with The Bank of Nova Scotia. The agreement establishes a credit facility for $3.4 million with a variable interest rate of 30-day LIBOR plus 3.5%. The loan term is for five years with monthly interest and principal payments. The purpose of the loan was to refinance the previously existing loan with ScotiaBank El Salvador, S.A. This loan is secured by assets of the Company's Honduras subsidiary.

On August 30, 2014, PriceSmart, Inc. entered into an agreement with MUFG Union Bank N.A. to increase our short-term borrowing facilities by approximately $15.0 million. The interest rate for day to day draw down of the facility is the prime rate.

On August 29, 2014, our El Salvador subsidiary entered into a loan agreement with The Bank of Nova Scotia. The agreement establishes a credit facility for $4.2 million with a variable interest rate of 30-day LIBOR plus 3.5%. The loan term is for five years with monthly interest and principal payments. This loan is secured by assets of our El Salvador subsidiary. On December 16, 2014, the Company's El Salvador subsidiary entered into an interest rate swap agreement with the Bank of Nova Scotia for a notional amount of $4.0 million related to this loan. The interest rate swap agreement converts the El Salvador subsidiary's floating interest payments of the $4.0 million long-term monthly amortizing debt with the Bank of Nova Scotia to fixed interest payments during the life of the hedging instrument. As changes in interest rates impact the future cash flows of loan interest payments, the hedge is intended to offset changes in cash flows attributable to variable interest rate movements. Under the interest rate swap agreement, the Company will receive variable interest based on the 1-month LIBOR rate plus 3.5% on a monthly amortizing notional amount of $4.0 million and pay fixed interest of 4.78% for a term of approximately five years (effective date of December 1, 2014 through August 29, 2019). The LIBOR reset dates for the hedged long-term debt and the interest rate

swap occur on the 29th day of each month beginning on December 29, 2014. The hedged loan was funded on August 29, 2014.

On August 29, 2014, our El Salvador subsidiary repaid the remaining balance of $4.1 million on the loan agreement entered into by the subsidiary on September 1, 2009 with Scotiabank El Salvador, S.A. The original agreement established a loan facility for $8.0 million. The interest rate was fixed at 5.5%. The loan term was for five years with monthly interest and principal payments. The loan facility was renewable for an additional five-year period upon approval of Scotiabank El Salvador, S.A.

On August 25, 2014, our Colombia subsidiary entered into a agreement to establish short-term borrowing facilities with Citibank-Colombia S.A. for approximately $10.9 million. The interest rate is the Inter Bank Rate plus 180 basis points set at the date of the funds draw down.

On March 31, 2014, our Panama subsidiary entered into a loan agreement with The Bank of Nova Scotia. The agreement establishes a credit facility of $34.0 million at a variable interest rate of 30-day LIBOR plus 3.5% for a five year term, monthly principal and interest payments, and a $17.0 million principal payment due at maturity. The facility provides a five year renewal option upon approval of the Bank of Nova Scotia. The loan is secured by assets of our Panama subsidiary. The purpose of the loan is to repay borrowings due to MetroBank, S.A. of $3.2 million and to fund our warehouse club expansion plans. During April 2014, we drew down $24.0 million of the $34.0 million facility and repaid the borrowings due to MetroBank, S.A. of $3.2 million. On May 22, 2014, the Company's Panama subsidiary entered into an interest rate swap agreement with the Bank of Nova Scotia for a notional amount of approximately $19.8 million. The interest rate swap agreement converts the Panama subsidiary's floating interest payments on the first $10.0 million of our initial $20.0 million borrowing under the long-term monthly amortizing debt with the Bank of Nova Scotia to fixed interest payments during the life of the hedging instrument. Under the interest rate swap agreement, the Company will receive variable interest based on the 1-month LIBOR rate plus 3.5% on a monthly amortizing notional amount of approximately $19.8 million. Additionally, on May 22, 2014, the Company's Panama subsidiary entered into another interest rate swap agreement with the Bank of Nova Scotia for a notional amount of approximately $4.0 million. The interest rate swap agreement converts the Panama subsidiary's floating interest payments on the first $2.0 million of the next $4.0 million borrowing under the long-term monthly amortizing debt with the Bank of Nova Scotia to fixed interest payments during the life of the hedging instrument. Under the interest rate swap agreement, the Company will receive variable interest based on the 1-month LIBOR rate plus 3.5% on a monthly amortizing notional amount of approximately $4.0 million. As changes in interest rates impact the future cash flows of the interest payments on the loans, the hedges are intended to offset changes in cash flows attributable to variable interest rate movements. The Panama Subsidiary pays fixed interest of 4.98% for a term of approximately five years (effective date of May 5, 2014 through April 4, 2019) on both interest rate swap agreements. The LIBOR reset dates for the hedged long-term debt and the interest rate swap agreements occur on the 4th day of each month beginning on June 4, 2014.

On March 31, 2014, our Panama subsidiary entered into a loan renewal agreement with The Bank of Nova Scotia renewing for an additional five years a 5.5% fixed rate loan originally entered into on August 21, 2009. The balance on the loan as of August 21, 2014 was $5.0 million. The renewal agreement became effective on August 21, 2014. The renewal agreement establishes a credit facility of $5.0 million at a variable interest rate of 30-day LIBOR plus 3.5%, for a five year term, with monthly principal and interest payments. The facility provides a five year renewal option upon approval of the Bank of Nova Scotia. On August 1, 2014, the Company's Panama subsidiary entered into an interest rate swap agreement with the Bank of Nova Scotia for a notional amount of $5.0 million. The interest rate swap agreement converts the Panama subsidiary's floating interest payments on the long-term monthly amortizing debt with the Bank of Nova Scotia to fixed interest payments during the life of the hedging instrument. As changes in interest rates impact the future cash flows of loan interest payments, the hedge is intended to offset changes in cash flows attributable to variable interest rate movements. Under the interest rate swap agreement, the Company will receive variable interest based on the 1-month LIBOR rate plus 3.5% on a monthly amortizing notional amount of $5.0 million and pay fixed interest of 4.89% for a term of approximately five years (effective date of August 21, 2014 through August 21, 2019). The LIBOR reset dates for the hedged long-term debt and the interest rate swap occur on the 21st day of each month beginning on September 22, 2014.

On March 7, 2014, our Honduras subsidiary entered into a loan agreement with Banco de America Central Honduras, S.A. The agreement establishes a credit facility for 286.0 million Lempiras, approximately USD $13.7 million. The loan has a variable interest rate of 12.75%, which will be reviewed semiannually. The interest rate may not be less than 12.5%. The loan is for 10 years with interest and principal payments due quarterly, subject to a 24-month grace period on principal payments. This loan is secured by assets of our Honduras subsidiary. On March 10, 2014, we drew down the full amount of the LPS 286.0 million loan.

On November 3, 2013, we paid down $8.0 million of the loan agreement entered into by our Colombia subsidiary on November 1, 2010 with Citibank, N.A. in New York. The original agreement established a loan facility for $16.0 million to be disbursed in two tranches of $8.0 million each; however, we did not draw down the second tranche. The interest rate was set at the six-month LIBOR rate plus 2.4%. The loan term was for five years with interest only payments and a balloon payment at

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maturity. The loan facility was renewable for an additional five-year period at the option of our Colombia subsidiary, but if we did not draw on the facility or pay off the loan, the facility would terminate. We have repaid this loan, and this loan facility has terminated. This loan was secured by a time deposit pledged by us equal to the amount outstanding on the loan. The secured time deposit of $8.0 million pledged by us was released on November 3, 2013.

Derivatives

We are exposed to certain risks relating to our ongoing business operations. One risk managed by us using derivative instruments is interest rate risk. To manage interest rate exposure, we enter into hedging transactions (interest rate swaps) using derivative financial instruments. The objective of entering into interest rate swaps is to eliminate the variability of cash flows in the interest payments associated with variable-rate LIBOR loans over the life of the loans. As changes in interest rates impact the future cash flow of interest payments, the hedges provide a synthetic offset to interest rate movements.

In addition, we are exposed to foreign currency and interest rate cash flow exposure related to non-functional currency long-term debt of two of our wholly owned subsidiaries. To manage foreign currency and interest rate cash flow exposure, these subsidiaries enter into cross-currency interest rate swaps that convert their U.S. dollar denominated floating interest payments to functional currency fixed interest payments during the life of the hedging instrument. As changes in foreign exchange and interest rates impact the future cash flow of interest payments, the hedges are intended to offset changes in cash flows attributable to interest rate and foreign exchange movements.

We are also exposed to foreign-currency exchange-rate fluctuations on U.S. dollar denominated liabilities within our international subsidiaries whose functional currency is other than the U.S. dollar. We manage these fluctuations, in part, through the use of non-deliverable forward foreign-exchange contracts that are intended to offset changes in cash flow attributable to currency exchange movements. The contracts are intended primarily to economically address exposure to U.S. dollar merchandise inventory expenditures made by our international subsidiaries whose functional currency is other than the U.S. dollar. We seek to mitigate foreign-currency exchange-rate risk with the use of these contracts and do not intend to engage in speculative transactions. Currently, these contracts do not contain any credit-risk-related contingent features. These contracts do not qualify for derivative hedge accounting. The forward currency hedges are not effective cash flow hedges because the notional amount and maturity date of the forward contract does not coincide with the accounts payable balance and due dates. The hedge ineffectiveness is measured by use of the "hypothetical derivative method," and we record the changes in the fair value of the forward contract related to the re-measurement of the payable at spot exchange rates as exchange rate gains or losses. The implied interest rate included within the forward contract is reflected in earnings as interest expense.

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction is determined to be ineffective. There were no such amounts for the periods reported herein.

The following table summarizes agreements for which we recorded cash flow hedge accounting transactions during the six months ended February 28, 2015:

| Subsidiary | Date Entered into | Derivative Financial Counter-party | Derivative Financial Instruments | Initial US$ Notional Amount | Bank US$ loan Held with | Floating Leg (swap counter-party) | Fixed Rate for PSMT Subsidiary | Settlement Dates | Effective Period of swap |
|---|---|---|---|---|---|---|---|---|---|
| El Salvador | 16-Dec-14 | Bank of Nova Scotia ("Scotiabank") | Interest rate swap | $4,000 | Bank of Nova Scotia | Variable rate 30-day Libor plus 3.5% | 4.78 % | 29th day of each month beginning on December 29, 2014 | December 01, 2014 - August 29, 2019 |
| Colombia | 10-Dec-14 | Citibank, N.A. ("Citi") | Cross currency interest rate swap | $15,000 | Citibank, N.A. | Variable rate 3-month Libor plus 2.8% | 8.25 % | 4th day of March, June, Sept, Dec. beginning on March 4, 2015 | December 4, 2014 - December 3, 2019 |
| Panama | 9-Dec-14 | Bank of Nova Scotia ("Scotiabank") | Interest rate swap | $10,000 | Bank of Nova Scotia | Variable rate 30-day Libor plus 3.5% | 5.159% | 28th day of each month beginning December 29, 2014 | November 28, 2014 - November 29, 2019 |
| Honduras | 23-Oct-14 | Citibank, N.A. ("Citi") | Cross currency interest rate swap | $5,000,000 | Citibank, N.A. | Variable rate 3-month Libor plus 3.5% | 11.6 % | 22nd day of January, April, July, and October beginning on January 22, 2015 | October 22, 2014 - October 22, 2017 |
| Panama | 1-Aug-14 | Bank of Nova Scotia ("Scotiabank") | Interest rate swap | $5,000,000 | Bank of Nova Scotia | Variable rate 30-day Libor plus 3.5% | 4.89 % | 21st day of each month beginning on September 22, 2014 | August 21, 2014 - August 21, 2019 |
| Panama | 22-May-14 | Bank of Nova Scotia ("Scotiabank") | Interest rate swap | $19,800,000 | Bank of Nova Scotia | Variable rate 30-day Libor plus 3.5% | 4.98 % | 4th day of each month beginning on June 4, 2014 | May 5, 2014 - April 4, 2019 |
| Panama | 22-May-14 | Bank of Nova Scotia ("Scotiabank") | Interest rate swap | $3,970,000 | Bank of Nova Scotia | Variable rate 30-day Libor plus 3.5% | 4.98 % | 4th day of each month beginning on June 4, | May 5, 2014 - April 4, 2019 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | 2014 | |
| Colombia | 11-Dec-12 | Bank of Nova Scotia ("Scotiabank") | Cross currency interest rate swap | $ | 8,000,000 | Bank of Nova Scotia | Variable rate 3-month Libor plus 0.7% | 4.79 % | March, June, September and December, beginning on March 5, 2013 | December 5, 2012 - December 5, 2014 |
| Colombia | 21-Feb-12 | Bank of Nova Scotia ("Scotiabank") | Cross currency interest rate swap | $ | 8,000,000 | Bank of Nova Scotia | Variable rate 3-month Libor plus 0.6% | 6.02 % | February, May, August and November beginning on May 22, 2012 | February 21, 2012 - February 21, 2017 |
| Colombia | 21-Oct-11 | Bank of Nova Scotia ("Scotiabank") | Cross currency interest rate swap | $ | 2,000,000 | Bank of Nova Scotia | Variable rate 3-month Libor plus 0.7% | 5.30 % | January, April, July and October, beginning on October 29, 2011 | July 29, 2011 - April 1, 2016 |
| Colombia | 21-Oct-11 | Bank of Nova Scotia ("Scotiabank") | Cross currency interest rate swap | $ | 6,000,000 | Bank of Nova Scotia | Variable rate 3-month Libor plus 0.7% | 5.45 % | March, June, September and December, beginning on December 29, 2011 | September 29, 2011 - April 1, 2016 |
| Colombia | 5-May-11 | Bank of Nova Scotia ("Scotiabank") | Cross currency interest rate swap | $ | 8,000,000 | Bank of Nova Scotia | Variable rate 3-month Libor plus 0.7% | 6.09 % | January, April, July and October, beginning on July 5, 2011 | April 1, 2011 - April 1, 2016 |

We measure the fair value for all financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis during the reporting period. We have designated the interest rate swaps and cross-currency interest rate swap agreements as hedging instruments and have accounted for them under hedge accounting rules. The following table summarizes the fair value of interest rate swaps and cross-currency interest rate swaps that qualify for derivative hedge accounting (in thousands, except footnote data):

| Derivative designated as cash flow hedging instruments | February 28, 2015 Balance Sheet Account | Fair Value | August 31, 2014 Balance Sheet Account | Fair Value |
|---|---|---|---|---|
| Cross currency interest rate swaps[1] | Prepaid expenses and current assets | $— | Prepaid expenses and current assets | $495 |
| Cross currency interest rate swaps[1] | Other non-current assets | 6,996 | Other non-current assets | 970 |
| Interest rate swaps[2] | Other non-current assets | — | Other non-current assets | 125 |
| Interest rate swaps[2] | Other long-term liabilities | (340) | Other long-term liabilities | — |
| Cross currency interest rate swaps[3] | Other long-term liabilities | (246) | Other long-term liabilities | — |
| Net fair value of derivatives designated as hedging instruments - assets (liability)[4] | | $6,410 | | $1,590 |

(1) The effective portion of the cross-currency interest rate swaps for this subsidiary was recorded to Accumulated other comprehensive (income)/loss for $(4.9) million and $(917,000) net of tax as of February 28, 2015 and August 31, 2014, respectively. The Company has recorded a deferred tax liability amount with an offset to other comprehensive income - tax of $(2.1) million and $(548,000) as of February 28, 2015 and August 31, 2014, respectively, related to asset positions of cross-currency interest rate swaps. However, the equity effect of this deferred tax liability is offset by the full valuation allowance provided for the net deferred tax asset recorded for this subsidiary.

(2) The effective portion of the interest rate swaps was recorded to Accumulated other comprehensive loss / (income) for $254,000 and $(94,000) net of tax as of February 28, 2015 and August 31, 2014, respectively. The Company has recorded a deferred tax asset / (liability) amount with an offset to other comprehensive income - tax of $86,000 and $(31,000) as of February 28, 2015 and August 31, 2014, respectively.

(3) The effective portion of the cross-currency interest rate swaps for this subsidiary was recorded to Accumulated other comprehensive (income)/loss for $172,000 and $0 net of tax as of February 28, 2015 and August 31, 2014, respectively. The Company has recorded a deferred tax asset amount with an offset to other comprehensive income - tax of $74,000 and $0 as of February 28, 2015 and August 31, 2014, respectively.

(4) Derivatives listed on the above table were designated as cash flow hedging instruments.

From time to time, we enter into non-deliverable forward exchange contracts. These contracts are treated for accounting purposes as fair value contracts and do not qualify for derivative hedge accounting.

The following table summarizes the fair value of foreign currency forward contracts that do not qualify for derivative hedge accounting (in thousands):

| Derivatives designated as fair value hedging instruments | February 28, 2015 Balance Sheet Location | Fair Value | August 31, 2014 Balance Sheet Location | Fair Value |
|---|---|---|---|---|
| Foreign currency forward contracts | Prepaid expenses and other current assets | $1,064 | Prepaid expenses and other current assets | $— |
| Foreign currency forward contracts | Other accrued expenses | — | Other accrued expenses | (14) |
| Net fair value of derivatives designated as hedging instruments | | $1,064 | | $(14) |

that do not qualify for hedge
accounting

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Short-Term Borrowings and Long-Term Debt

Short-term borrowings consist of lines of credit which are secured by certain assets of our domestic company and by our those of our subsidiaries. The short-term borrowing facilities are summarized below (in thousands):

| | Total Amount of Facilities | Facilities Used Short-term Borrowings | Letters of Credit | Facilities Available | Weighted average interest rate | |
|---|---|---|---|---|---|---|
| February 28, 2015 | $59,387 | $4,470 | $380 | $54,537 | 5.86 | % |
| August 31, 2014 | $61,869 | $— | $436 | $61,433 | N/A | |

As of February 28, 2015 we had approximately $40.0 million of short-term facilities in the U.S. that require us to comply with certain quarterly financial covenants, which include debt service and leverage ratios. As of February 28, 2015 and August 31, 2014, we were in compliance with respect to these covenants.
The following table provides the changes in our long-term debt for the six months ended February 28, 2015:

| (Amounts in millions) | Current Portion of Long-term debt | | Long-term debt | | Total | |
|---|---|---|---|---|---|---|
| Balances as of August 31, 2014 | $11,848 | | $79,591 | | $91,439 | [1] |
| Proceeds from long-term debt incurred during the period: | | | | | | |
| Panama subsidiary | 1,000 | | 9,000 | | 10,000 | |
| Honduras subsidiary | 1,600 | | 6,750 | | 8,350 | |
| Colombia subsidiary | 1,500 | | 13,500 | | 15,000 | |
| Trinidad subsidiary | 907 | | 2,720 | | 3,627 | |
| Repayments of long-term debt: | | | | | | |
| Repayment of loan by Honduras subsidiary, originally entered into on January 12, 2012 with Scotiabank El Salvador, S.A. | (3,200 | ) | — | | (3,200 | ) |
| Partial repayment of loan by Honduras subsidiary, originally entered into on March 7, 2014 with Banco de America Central Honduras, S.A. | — | | (5,000 | ) | (5,000 | ) |
| Repayment of loan by Honduras subsidiary, originally entered into on March 6, 2010 with Banco del Pais, S.A. | (87 | ) | — | | (87 | ) |
| Repayment of loan by Trinidad subsidiary, originally entered into on August 26, 2008 with Royal Bank of Trinidad and Tobago, Ltd. | (900 | ) | (2,325 | ) | (3,225 | ) |
| Regularly scheduled loan payments | (579 | ) | (4,567 | ) | (5,146 | ) |
| Reclassifications of long-term debt | 2,850 | | (2,850 | ) | — | |
| Translation adjustments on foreign-currency debt of subsidiaries whose functional currency is not the U.S. dollar [2] | (147 | ) | (6,491 | ) | (6,638 | ) |
| Balances as of February 28, 2015 | $14,792 | | $90,328 | | $105,120 | [3] |

(1) The carrying amount cash assets assigned as collateral for this total was $24.6 million and the carrying amount on non-cash assets assigned as collateral for this total was $84.2 million.
(2) These foreign currency translation adjustments are recorded within Other comprehensive income.
(3)

The carrying amount cash assets assigned as collateral for this total was $24.0 million and the carrying amount on non-cash assets assigned as collateral for this total was $103.5 million.

As of February 28, 2015, we had approximately $78.3 million of long-term loans in Trinidad, Panama, El Salvador, Honduras and Colombia that require these subsidiaries to comply with certain annual or quarterly financial covenants, which



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include debt service and leverage ratios. As of February 28, 2015 the Company was in compliance with all covenants, amended covenants.

As of August 31, 2014, we had approximately $62.5 million of long-term loans in Trinidad, Panama, El Salvador, Honduras and Colombia that require these subsidiaries to comply with certain annual or quarterly financial covenants, which include debt service and leverage ratios. As of August 31, 2014, we were in compliance with all covenants or amended covenants.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements that have had, or are reasonably likely to have, a material current or future effect on its financial condition or consolidated financial statements.

Repurchase of Equity Securities and Reissuance of Treasury Shares
At the vesting dates for restricted stock awards to our employees, we repurchase a portion of the shares that have vested at the prior day's closing price per share, with the funds used to pay the employees' minimum statutory tax withholding requirements related to the vesting of restricted stock awards. We do not have a stock repurchase program.
Shares of common stock repurchased by us are recorded at cost as treasury stock and result in the reduction of stockholders' equity in our Consolidated Balance Sheets. We may reissue these treasury shares. When treasury shares are reissued, we use the first in/first out ("FIFO") cost method for determining cost of the reissued shares. If the issuance price is higher than the cost, the excess of the issuance price over the cost is credited to additional paid-in capital ("APIC"). If the issuance price is lower than the cost, the difference is first charged against any credit balance in APIC from treasury stock and the balance is charged to retained earnings.

The following table summarizes the shares repurchased during fiscal years 2015 and 2014:

| | Six Months Ended February 28, | |
|---|---|---|
| | 2015 | 2014 |
| Shares repurchased | 49,931 | 48,291 |
| Cost of repurchase of shares (in thousands) | $4,441 | $4,548 |

We have reissued treasury shares as part of our stock-based compensation programs. However, as summarized below, no treasury shares were reissued during the periods presented as of August 31:

| | Six Months Ended February 28, | |
|---|---|---|
| | 2015 | 2014 |
| Reissued treasury shares | — | — |

Critical Accounting Estimates

The preparation of our consolidated financial statements requires that management make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Some of our accounting policies require management to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Management continues to review its accounting policies and evaluate its estimates, including those related to contingencies and litigation, income taxes, tax receivables, and long-lived assets. We base our estimates on historical experience and on other assumptions that management believes

to be reasonable under the present circumstances. Using different estimates could have a material impact on our financial condition and results of operations.



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Contingencies and Litigation: In the ordinary course of business, we are periodically named as a defendant in various lawsuits, claims and pending actions and are exposed to tax risks (other than income tax). The principal risks that we insure against are workers' compensation, general liability, vehicle liability, property damage, employment practices, errors and omissions, fiduciary liability and fidelity losses. If a potential loss arising from these lawsuits, claims, actions and non-income tax issues is probable and reasonably estimable, we record the estimated liability based on circumstances and assumptions existing at the time. The estimates affecting our litigation reserves can be affected by new claims filed after the balance sheet date with respect to events occurring prior to the balance sheet date and developments in pending litigation that may affect the outcome of the litigation. While we believe the recorded liabilities are adequate, there are inherent limitations in projecting the outcome of litigation and in evaluating the probable additional tax associated with various non-income tax filing positions. As such, we are unable to make a reasonable estimate of the sensitivity to change of estimates affecting our recorded liabilities. As additional information becomes available, we assess the potential liability and revise our estimates as appropriate.

Income Taxes: We account for income taxes using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and carry-forwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established when necessary to reduce deferred tax assets to amounts expected to be realized. As of February 28, 2015, we evaluated our deferred tax assets and liabilities and determined that a valuation allowance was necessary for certain foreign deferred tax asset balances, primarily because of the existence of significant negative objective evidence, such as the fact that certain subsidiaries are in a cumulative loss position for the past three years, indicating that certain net operating loss carry-forward periods are not sufficient to realize the related deferred tax assets.

We and our subsidiaries are required to file federal and state income tax returns in the United States and various other tax returns in foreign jurisdictions. The preparation of these tax returns requires us to interpret the applicable tax laws and regulations in effect in such jurisdictions, which could affect the amount of tax we pay. In consultation with our tax advisors, we base our tax returns on interpretations that we believed to be reasonable under the circumstances. The tax returns, however, are subject to routine reviews by the various federal, state and foreign taxing authorities in the jurisdictions in which we or one of our subsidiaries file tax returns. As part of these reviews, a taxing authority may disagree with respect to the income tax positions we have taken ("uncertain tax positions") and, therefore, require us or one of our subsidiaries to pay additional taxes.

We accrue an amount for our estimate of probable additional income tax liability. In certain cases, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained. This requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. When facts and circumstances change, we reassess these probabilities and record any changes in the consolidated financial statements as appropriate. There were no material changes in our uncertain income tax positions for the periods ended on February 28, 2015 and August 31, 2014. However, during the fiscal year 2014, we were required to make payments of $4.2 million to the governments in two countries with respect to various income tax cases that we are currently appealing, but we believe we will eventually prevail. These amounts have been recorded in the balance sheet as other non-current assets, as we consider these a payment on account and expect to get a refund thereof upon eventually prevailing on these cases, but we are unsure of the timing thereof. Furthermore, during the first quarter of fiscal year 2015, one of the Company's subsidiaries received provisional assessments claiming $2.6 million of taxes, penalties and interest related to withholding taxes on certain charges for services rendered by the Company. In addition, during the first quarter of fiscal year 2015, this subsidiary received provisional assessments totaling $5.2 million for lack of deductibility of the

underlying service charges due to the lack of withholding.  Based on the Company's interpretation of local law, rulings and jurisprudence (including Supreme Court precedents with respect to the deductibility assessment), the Company expects to prevail in both instances and has not recorded a provision for these assessments.

We have not provided for U.S. deferred taxes on cumulative non-U.S. undistributed earnings as we deem such earnings to be indefinitely reinvested. It is not practicable to determine the U.S. federal income tax liability that would be associated with the repatriation earnings because of the complexity of the computation.

Tax Receivables: We pay Value Added Tax ("VAT") or similar taxes ("input VAT"), income taxes, and other taxes within the normal course of our business in most of the countries in which we operate related to the procurement of merchandise and/or services we acquires and/or on estimated sales and taxable income. We also collect VAT or similar taxes on behalf of the government ("output VAT") for merchandise and/or services we sell. If the output VAT exceeds the input VAT, then the difference is remitted to the government, usually on a monthly basis. If the input VAT exceeds the output VAT, this creates a VAT receivable. In some countries where we operate, the governments have implemented additional collection procedures, such as requiring credit card processors to remit a portion of sales processed via credit card directly to the government as advance payments of VAT and/or income tax. In the case of VAT, these procedures alter the natural offset of input and output VAT and generally leave us with a net VAT receivable, forcing us to process significant refund claims on a recurring basis. With respect to income taxes paid, if the estimated income taxes paid or withheld exceed the actual income tax due this creates an income tax receivable. We either request a refund of these tax receivables or apply the balance to expected future tax payments. These refund or offset processes can take anywhere from several months to several years to complete.

In most countries where we operate, the tax refund process is defined and structured with regular refunds or offsets. However, in two countries the respective governments have alleged that there is no defined process in the law to allow them to refund VAT receivables. We together with our tax and legal advisers are currently appealing these interpretations in court and expect to prevail. In one of these countries, where there is recent favorable jurisprudence, the government has recently begun an audit to verify the amount of the respective VAT receivables as a required precursor to any refund. The balance of the VAT receivable in these countries was $6.3 million and $5.7 million as of February 28, 2015 and August 31, 2014, respectively. In another country, beginning in fiscal year 2015, a new minimum income tax mechanism took effect, which requires us to pay taxes based on factor of sales rather than income. This will likely result in our having to make income tax payments substantially in excess of those due based on taxable income. The current rules (which we have appealed) do not allow us to obtain a refund or offset this excess income tax against other taxes. Due to the timing of these rules, as of February 28, 2015, the Company currently has an outstanding income tax receivable of $178,000 in this country; and there were deferred tax assets of approximately $1.1 million outstanding as of that date. We have not placed any type of allowance on the recoverability of these tax receivables or deferred income taxes.

Our policy for classification and presentation of VAT receivables, income tax receivables and other tax receivables is as follows:

•Short-term VAT and Income tax receivables, recorded as Other current assets: This classification is used for any countries where our subsidiary has generally demonstrated the ability to recover the VAT or income tax receivable within one year. We also classify as short-term any approved refunds or credit notes to the extent that we expect to receive the refund or use the credit notes within one year.

•Long-term VAT and Income tax receivables, recorded as Other non-current assets: This classification is used for amounts not approved for refund or credit in countries where our subsidiary has not demonstrated the ability to obtain refunds within one year and/or for amounts which are subject to outstanding disputes. An allowance is provided against VAT and income tax receivable balances in dispute when we do not expect to eventually prevail in its recovery.

Long-lived Assets: We periodically evaluate our long-lived assets for indicators of impairment. Indicators that an asset may be impaired are:

- the asset's inability to continue to generate income from operations and positive cash flow in future periods;
- loss of legal ownership or title to the asset;
- significant changes in its strategic business objectives and utilization of the asset(s); and

- the impact of significant negative industry or economic trends.

Management's judgments are based on market and operational conditions at the time of the evaluation and can include management's best estimate of future business activity, which in turn drives estimates of future cash flows from these assets. These periodic evaluations could cause management to conclude that impairment factors exist, requiring an adjustment of these assets to their then-current fair market value. Future business conditions and/or activity could differ materially from the projections made by management causing the need for additional impairment charges. No impairment charges have been recorded during fiscal year 2015.

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 that we serve, 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 or less expensive in local currencies and therefore more or 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risks relating to our operations result primarily from changes in interest rates and changes in currency exchange rates. There have been no material changes in our market risk factors at February 28, 2015 compared to those disclosed in our Annual Report on Form 10-K for the fiscal year ended August 31, 2014. At February 28, 2015, the fair value of our derivative financial instruments designated as cash flow hedges have increased approximately $3.5 million, net of tax since August 31, 2014, primarily due to a devaluation of the currencies that are being hedged and the scheduled maturities of the underlying instruments during the six months ended February 28, 2015. Movements in currency exchange rates and the related impact on the translation of the balance sheets of the Company's subsidiaries whose functional currency is not the U.S. dollar were the primary cause of the $(22.6) million net loss for the six months ended February 28, 2015 in the foreign currency translation adjustments category of accumulated other comprehensive income (loss).
In addition, the Company's subsidiaries whose functional currency is not the U.S. dollar carry monetary assets and liabilities denominated in currencies other than the functional currency of the respective entity (primarily U.S. dollars) are revalued to the functional currency using the exchange rate on the balance sheet date. These foreign exchange transaction gains (losses), including transactions recorded involving these monetary assets and liabilities, are recorded as currency gain (loss) within Other income (expense) in the consolidated statements of income.
During the six months ended February 28, 2015, the Colombian peso depreciated 29.0% relative to the U.S. dollar. The impact of this depreciation had a material impact on the Company’s consolidated results due to the high level of U.S. dollar denominated inter-company liabilities held by its Colombian subsidiary. These U.S. dollar denominated inter-company liabilities were greater than what we would expect from normal operations because of the impact of the subsidiary’s initial acquisition of merchandise to stock the three new warehouse clubs opened in October and November 2014. Other subsidiaries that had greater U.S. dollar denominated cash and cash equivalents (including restricted cash) than their U.S. dollar denominated liabilities did not experience similar depreciation in their markets and therefore did not counterbalance the impact of the depreciation in Colombia. Although we cannot predict future changes in exchange rates, we believe that we will be less susceptible to such fluctuations in future periods because the Colombia subsidiary’s U.S. dollar denominated inter-company liabilities have been paid down to a normalized level.
The following table summarizes the amounts recorded for the three and six month period ending February 28, 2015 and 2014 (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | February 28, 2015 | February 28, 2014 | February 28, 2015 | February 28, 2014 |
| Currency gain (loss) | $(1,659) | $712 | $(4,291) | $1,023 |

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the timelines specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decision regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, we have investments in certain unconsolidated entities. Because we do not control or manage those entities, our control procedures with respect to those entities were substantially more limited than those we maintain with respect to our consolidated subsidiaries.

As required by SEC Rules 13a-15(e) or 15d-15(e), we carried out an evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon their evaluation, the Principal Executive Officer and Principal Financial Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level.

In the ordinary course of business, we review our system of internal control over financial reporting and make changes to our systems and processes to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems and automating manual processes. There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

The certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 are filed as Exhibit 31.1 and 31.2 to this report.



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## PART II—OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

None.

### ITEM 1A. RISK FACTORS

In addition to the other information set forth in this Quarterly Report on Form 10-Q, the reader should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended August 31, 2014. There have been no material changes in the Company's risk factors from those disclosed in Part I, Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2014.

Available Information

The PriceSmart, Inc. website or internet address is www.pricesmart.com. On this website the Company makes available, free of charge, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports, and the annual report to the security holders as soon as reasonably practicable after electronically filing such material with or furnishing it to the U.S. Securities and Exchange Commission (SEC). The Company's SEC reports can be accessed through the investor relations section of its website under "SEC Filings." All of the Company's filings with the SEC may also be obtained at the SEC's Public Reference Room at Room 1580, 100 F Street NE, Washington, DC 20549. For information regarding the operation of the SEC's Public Reference Room, please contact the SEC at 1-800-SEC-0330. Additionally, the SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at www.sec.gov. The Company made available its annual report on Form 10-K and its annual Proxy Statement for the fiscal year 2014 at the internet address http://materials.proxyvote.com/741511.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) None.

(b) None.

(c) Purchase of Equity Securities by the Issuer and Affiliated Purchasers.

Upon vesting of restricted stock awarded by the Company to employees, the Company repurchases shares and withholds the amount of the repurchase payment to cover employees' tax withholding obligations. As set forth in the table below, during the quarter ended February 28, 2015, the Company repurchased a total of 49,931 shares in the indicated months. These were the only repurchases of equity securities made by the Company during fiscal year 2015. The Company does not have a stock repurchase program.

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid Per Share | (c) Total Number of Shares Purchased as Part of Publicly | (d) Maximum Number of Shares That May Yet Be Purchased |
|---|---|---|---|---|

| | | | Announced Plans or Programs | Under the Plans or Programs |
|---|---|---|---|---|
| December 1, 2014 - December 31, 2014 | — | $— | — | N/A |
| January 1, 2015 - January 31, 2015 | 49,931 | 88.95 | — | N/A |
| February 1, 2015 - February 28, 2015 | — | — | — | N/A |
| Total | 49,931 | $ 88.95 | — | — |

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

PRICESMART, INC.

ITEM 6. EXHIBITS

(a) Exhibits:

| | |
|---|---|
| 3.1(1) | Amended and Restated Certificate of Incorporation of the Company. |
| 3.2(2) | Certificate of Amendment of Amended and Restated Certificate of Incorporation of the Company. |
| 3.3(3) | Certificate of Amendment of Amended and Restated Certificate of Incorporation of the Company. |
| 3.4(1) | Amended and Restated Bylaws of the Company. |
| 10.1 | Fifth Amendment to Employment Agreement between the Company and John Heffner, dated January 1, 2015. |
| 10.2 | Sixteenth Amendment to Employment Agreement between the Company and William Naylon, dated January 1, 2015. |
| 10.3 | Twenty-Fifth Amendment to Employment Agreement between the Company and John Hildebrandt, dated January 1, 2015. |
| 10.4 | Twenty-Fifth Amendment to Employment Agreement between the Company and Jose Luis Laparte, dated January 1, 2015. |
| 10.5 | Twenty-Seventh Amendment to Employment Agreement between the Company and Brud Drachman, dated January 1, 2015. |
| 10.6 | Twenty-Ninth Amendment to Employment Agreement between the Company and Thomas Martin, dated January 1, 2015. |
| 10.7 | Thirty-Fifth Amendment to Employment Agreement between the Company and Robert M. Gans, Dated January 1, 2015. |
| 10.8 | Fourth Amendment to Lease (Expansion) between the Company and CREA Centrewest LP, dated January 29, 2015. |
| 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1** | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2** | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Identifies management contract or compensatory plan or arrangement.

** These certifications are being furnished solely to accompany this Report pursuant to 18 U.S.C. 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and are not to be incorporated by reference into any filing of PriceSmart, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.

(1) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended August 31, 1997 filed with the Commission on November 26, 1997.

(2) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended February 29, 2004 filed with the Commission on April 14, 2004.

(3) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended August 31, 2004 filed with the Commission on November 24, 2004.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

| | PRICESMART, INC. | |
|---|---|---|
| Date: April 9, 2015 | By: | /s/ JOSE LUIS LAPARTE<br>Jose Luis Laparte<br>Director, Chief Executive Officer and President<br>(Principal Executive Officer) |
| Date: April 9, 2015 | By: | /s/ JOHN M. HEFFNER<br>John M. Heffner<br>Executive Vice President and Chief Financial Officer<br>(Principal Financial Officer and<br>Principal Accounting Officer) |

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