

Container Store Group, Inc.
Form 10-Q
February 06, 2019
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the Quarterly Period Ended December 29, 2018

OR

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

For the transition period from to

Commission File Number: 001-36161

THE CONTAINER STORE GROUP, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: Container Store Group, Inc. - Form 10-Q

Delaware
(State or other jurisdiction of incorporation or organization)

26-0565401
(IRS Employer Identification No.)

500 75019
Freeport
Parkway,
Coppell, TX
(Addresses (Zip
of principal Codes)
executive offices)

Registrant's telephone number in the United States, including area code, is: (972) 538-6000

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer
Smaller reporting company Emerging growth company

Edgar Filing: Container Store Group, Inc. - Form 10-Q

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The registrant had 48,912,177 shares of its common stock outstanding as of February 1, 2019.

Table of Contents

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Unaudited Consolidated Balance Sheets as of December 29, 2018, March 31, 2018, and December 30, 2017 3

Unaudited Consolidated Statements of Operations for the Thirteen and Thirty-Nine Weeks ended December 29, 2018 and December 30, 2017 5

Unaudited Consolidated Statements of Comprehensive Income for the Thirteen and Thirty-Nine Weeks ended December 29, 2018 and December 30, 2017 6

Unaudited Consolidated Statements of Cash Flows for the Thirty-Nine Weeks ended December 29, 2018 and December 30, 2017 7

Notes to the Unaudited Consolidated Financial Statements 8

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations 20

Item 3. Quantitative and Qualitative Disclosures About Market Risk 36

Item 4. Controls and Procedures 36

PART II. OTHER INFORMATION

Item 1. Legal Proceedings 38

Item 1A. Risk Factors 38

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 38

Item 3. Default Upon Senior Securities 38

Item 4. Mine Safety Disclosures 38

Item 5. Other Information 38

Item 6. Exhibits 39

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

The Container Store Group, Inc.

Consolidated balance sheets

| (In thousands) | December 29, 2018 (unaudited) | March 31, 2018 | December 30, 2017 (unaudited) |
|-------------------------------------|-------------------------------------|-------------------|-------------------------------------|
| Assets | | | |
| Current assets: | | | |
| Cash | \$ 20,969 | \$ 8,399 | \$ 22,653 |
| Accounts receivable, net | 29,549 | 25,528 | 29,548 |
| Inventory | 116,006 | 97,362 | 110,391 |
| Prepaid expenses | 8,877 | 11,281 | 11,668 |
| Income taxes receivable | 640 | 15 | 1,450 |
| Other current assets | 10,404 | 11,609 | 10,338 |
| Total current assets | 186,445 | 154,194 | 186,048 |
| Noncurrent assets: | | | |
| Property and equipment, net | 151,860 | 158,389 | 160,836 |
| Goodwill | 202,815 | 202,815 | 202,815 |
| Trade names | 226,996 | 229,401 | 230,379 |
| Deferred financing costs, net | 259 | 312 | 329 |
| Noncurrent deferred tax assets, net | 1,898 | 2,404 | 2,308 |
| Other assets | 1,749 | 1,854 | 1,684 |
| Total noncurrent assets | 585,577 | 595,175 | 598,351 |
| Total assets | \$ 772,022 | \$ 749,369 | \$ 784,399 |

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated balance sheets (continued)

| (In thousands, except share and per share amounts) | December 29, 2018 (unaudited) | March 31, 2018 | December 30, 2017 (unaudited) |
|--|-------------------------------------|-------------------|-------------------------------------|
| Liabilities and shareholders' equity | | | |
| Current liabilities: | | | |
| Accounts payable | \$ 59,571 | \$ 43,692 | \$ 53,757 |
| Accrued liabilities | 67,708 | 70,494 | 73,539 |
| Current portion of long-term debt | 7,018 | 7,771 | 9,465 |
| Income taxes payable | 1,589 | 4,580 | 1,690 |
| Other current liabilities | 67 | — | — |
| Total current liabilities | 135,953 | 126,537 | 138,451 |
| Noncurrent liabilities: | | | |
| Long-term debt | 297,895 | 277,394 | 304,638 |
| Noncurrent deferred tax liabilities, net | 50,397 | 54,839 | 56,706 |
| Deferred rent and other long-term liabilities | 36,339 | 41,892 | 32,941 |
| Total noncurrent liabilities | 384,631 | 374,125 | 394,285 |
| Total liabilities | 520,584 | 500,662 | 532,736 |
| Commitments and contingencies (Note 6) | | | |
| Shareholders' equity: | | | |
| Common stock, \$0.01 par value, 250,000,000 shares authorized; 48,142,319 shares issued at December 29, 2018; 48,072,187 shares issued at March 31, 2018; 48,072,187 shares issued at December 30, 2017 | 481 | 481 | 481 |
| Additional paid-in capital | 863,119 | 861,263 | 860,827 |
| Accumulated other comprehensive loss | (22,646) | (17,316) | (14,323) |
| Retained deficit | (589,516) | (595,721) | (595,322) |
| Total shareholders' equity | 251,438 | 248,707 | 251,663 |
| Total liabilities and shareholders' equity | \$ 772,022 | \$ 749,369 | \$ 784,399 |

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated statements of operations

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|--|----------------------|--------------|-------------------------|--------------|
| | December 29, | December 30, | December 29, | December 30, |
| (In thousands, except share and per share amounts) (unaudited) | 2018 | 2017 | 2018 | 2017 |
| Net sales | \$ 221,637 | \$ 222,986 | \$ 641,913 | \$ 624,464 |
| Cost of sales (excluding depreciation and amortization) | 91,580 | 92,425 | 266,510 | 263,919 |
| Gross profit | 130,057 | 130,561 | 375,403 | 360,545 |
| Selling, general, and administrative expenses (excluding depreciation and amortization) | 108,688 | 103,894 | 320,949 | 306,866 |
| Stock-based compensation | 632 | 585 | 1,987 | 1,589 |
| Pre-opening costs | 691 | 1,872 | 1,918 | 4,676 |
| Depreciation and amortization | 8,887 | 9,477 | 27,352 | 28,524 |
| Other expenses | 80 | 751 | 297 | 4,908 |
| (Gain) loss on disposal of assets | (324) | 83 | (284) | 236 |
| Income from operations | 11,403 | 13,899 | 23,184 | 13,746 |
| Interest expense, net | 6,008 | 7,300 | 21,293 | 17,398 |
| Loss on extinguishment of debt | — | — | 2,082 | 2,369 |
| Income (loss) before taxes | 5,395 | 6,599 | (191) | (6,021) |
| Benefit for income taxes | (3,926) | (21,780) | (5,989) | (25,848) |
| Net income | \$ 9,321 | \$ 28,379 | \$ 5,798 | \$ 19,827 |
| Net income per common share — basic and diluted | \$ 0.19 | \$ 0.59 | \$ 0.12 | \$ 0.41 |
| Weighted-average common shares — basic | 48,139,582 | 48,067,754 | 48,139,132 | 48,057,974 |
| Weighted-average common shares — diluted | 48,381,455 | 48,167,882 | 48,407,337 | 48,128,682 |

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated statements of comprehensive income

| (In thousands) (unaudited) | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|--|----------------------|----------------------|-------------------------|----------------------|
| | December 29, 2018 | December 30, 2017 | December 29, 2018 | December 30, 2017 |
| Net income | \$ 9,321 | \$ 28,379 | \$ 5,798 | \$ 19,827 |
| Unrealized gain (loss) on financial instruments, net of tax provision (benefit) of \$216, (\$595), (\$196) and \$951 | 660 | (713) | (687) | 1,687 |
| Pension liability adjustment | (3) | 5 | 132 | (175) |
| Foreign currency translation adjustment | (136) | 480 | (4,775) | 6,808 |
| Comprehensive income | \$ 9,842 | \$ 28,151 | \$ 468 | \$ 28,147 |

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated statements of cash flows

| (In thousands) (unaudited) | Thirty-Nine Weeks Ended | |
|---|-------------------------|----------------------|
| | December 29, 2018 | December 30, 2017 |
| Operating activities | | |
| Net income | \$ 5,798 | \$ 19,827 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 27,352 | 28,524 |
| Stock-based compensation | 1,987 | 1,589 |
| (Gain) loss on disposal of assets | (284) | 236 |
| Loss on extinguishment of debt | 2,082 | 2,369 |
| Deferred tax benefit | (3,959) | (27,255) |
| Non-cash interest | 1,886 | 1,905 |
| Other | (35) | 326 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (4,655) | (727) |
| Inventory | (22,013) | (2,665) |
| Prepaid expenses and other assets | 4,853 | 233 |
| Accounts payable and accrued liabilities | 13,475 | 19,627 |
| Income taxes | (3,564) | (2,461) |
| Other noncurrent liabilities | (5,100) | (2,136) |
| Net cash provided by operating activities | 17,823 | 39,392 |
| Investing activities | | |
| Additions to property and equipment | (21,328) | (20,101) |
| Proceeds from sale of property and equipment | 915 | 19 |
| Net cash used in investing activities | (20,413) | (20,082) |
| Financing activities | | |
| Borrowings on revolving lines of credit | 40,256 | 47,054 |
| Payments on revolving lines of credit | (40,256) | (47,054) |
| Borrowings on long-term debt | 326,500 | 335,000 |
| Payments on long-term debt and capital leases | (308,251) | (331,885) |
| Payment of debt issuance costs | (2,384) | (11,246) |
| Payment of taxes with shares withheld upon restricted stock vesting | (128) | (39) |
| Net cash provided by (used in) financing activities | 15,737 | (8,170) |
| Effect of exchange rate changes on cash | (577) | 777 |
| Net increase in cash | 12,570 | 11,917 |
| Cash at beginning of fiscal period | 8,399 | 10,736 |
| Cash at end of fiscal period | \$ 20,969 | \$ 22,653 |

Edgar Filing: Container Store Group, Inc. - Form 10-Q

Supplemental information for non-cash investing and financing activities:

| | | |
|--|----------|--------|
| Purchases of property and equipment (included in accounts payable) | \$ 2,619 | \$ 894 |
| Capital lease obligation incurred | \$ 169 | \$ 178 |

See accompanying notes.

7

Table of Contents

The Container Store Group, Inc.

Notes to consolidated financial statements (unaudited)

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

December 29, 2018

1. Description of business and basis of presentation

These financial statements should be read in conjunction with the financial statement disclosures in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the Securities and Exchange Commission on May 31, 2018. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). We use the same accounting policies in preparing quarterly and annual financial statements. All adjustments necessary for a fair presentation of quarterly operating results are reflected herein and are of a normal, recurring nature. Certain items in these consolidated financial statements have been reclassified to conform to the current period presentation.

Description of business

The Container Store, Inc. was founded in 1978 in Dallas, Texas, as a retailer with a mission to provide customers with storage and organization solutions through an assortment of innovative products and unparalleled customer service. In 2007, The Container Store, Inc. was sold to The Container Store Group, Inc. (the “Company”), a holding company, of which a majority stake was purchased by Leonard Green and Partners, L.P. (“LGP”), with the remainder held by certain employees of The Container Store, Inc. On November 6, 2013, the Company completed its initial public offering (the “IPO”). As the majority shareholder, LGP retains a controlling interest in the Company. As of December 29, 2018, The Container Store, Inc. (“TCS”) operates 92 stores with an average size of approximately 25,000 square feet (19,000 selling square feet) in 33 states and the District of Columbia. The Container Store, Inc. also offers all of its products directly to its customers, including business-to-business customers, through its website and call center. The Container Store, Inc.’s wholly-owned Swedish subsidiary, Elfa International AB (“Elfa”), designs and manufactures component-based shelving and drawer systems and made-to-measure sliding doors. elfa® branded products are sold exclusively in the United States in The Container Store retail stores, website and call center, and Elfa sells to various retailers on a wholesale basis in approximately 30 countries around the world, with a concentration in the Nordic region of Europe.

Seasonality

The Company's business is moderately seasonal in nature and, therefore, the results of operations for the thirty-nine weeks ended December 29, 2018 are not necessarily indicative of the operating results for the full year. The Company has historically realized a higher portion of net sales, operating income, and cash flows from operations in the fourth fiscal quarter, attributable primarily to the timing and impact of Our Annual elfa® Sale, which traditionally starts in late December and runs into February.

Revenue recognition

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers, an updated standard on revenue recognition. The Company adopted this standard in the first quarter of fiscal 2018 and elected to use the modified-retrospective approach for implementation of the standard. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the Company expects to be entitled in exchange for those goods or services.

The Company has identified certain impacts to our accounting for gift cards given away for promotional or marketing purposes. Under previous GAAP, the value of promotional gift cards was recorded as selling, general, and administrative ("SG&A") expense. The new standard requires these types of gift cards to be accounted for as a reduction of revenue (i.e. a discount). Additionally, ASU 2014-09 disallows the capitalization of direct-response advertising costs which will impact the timing of recognition of certain advertising production and distribution costs.

Table of Contents

Upon transition on April 1, 2018, the Company recorded a cumulative adjustment to increase retained earnings/(deficit) and to decrease accrued liabilities by approximately \$400. The Company also reclassified the asset balance for the estimate of future returned merchandise, which was approximately \$900 as of March 31, 2018, from the "Inventory" line to the "Other current assets" line on the balance sheet. Overall, the adoption of ASU 2014-09 did not result in a material impact to the Company's financial statements. Note 10 provides the related disaggregated revenue disclosures.

We recognize revenues and the related cost of goods sold for our TCS segment when merchandise is received by our customers. We recognize revenues and the related cost of goods sold for our Elfa segment upon shipment. We recognize shipping and handling fees as revenue when the merchandise is delivered to the customer. Costs of shipping and handling are included in cost of goods sold. We recognize fees for installation and other services as revenue upon completion of the service to the customer. Costs of installation and other services are included in cost of goods sold. Sales tax collected is not recognized as revenue as it is ultimately remitted to governmental authorities. We reserve for projected merchandise returns based on historical experience and various other assumptions that we believe to be reasonable. The reserve reduces sales and cost of sales, accordingly. Merchandise exchanges of similar product and price are not considered merchandise returns and, therefore, are excluded when calculating the sales returns reserve.

Contract Balances

Contract balances as a result of transactions with customers primarily consist of trade receivables included in Accounts receivable, net, unearned revenue included in Accrued liabilities, and gift cards and store credits outstanding included in Accrued liabilities in the Company's Consolidated Balance Sheets. Note 2 provides the Company's trade receivables, unearned revenue, and gift cards and store credits outstanding with customers as of December 29, 2018, March 31, 2018, and December 30, 2017.

Below is a rollforward of contract liability balances from March 31, 2018 to December 29, 2018, which illustrates the amount of contract liability as of March 31, 2018 which was subsequently recognized into revenue in the thirty-nine weeks ended December 29, 2018:

| | Contract liability balance at March 31, 2018 (1) | Revenue recognized from beginning liability | Contract liabilities added during period (2) | Contract liability balance at December 29, 2018 |
|--|--|---|--|---|
| Unearned revenue | \$ 11,080 | \$ (10,735) | \$ 10,596 | \$ 10,941 |
| Gift cards and store credits outstanding | \$ 8,470 | \$ (2,623) | \$ 3,715 | \$ 9,562 |

(1) Gift cards and store credits outstanding balance is net of revenue recognition transition adjustment

(2) Net of estimated breakage

Recent accounting pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), to revise lease accounting guidance. The update requires most leases to be recorded on the balance sheet as a lease liability, with a corresponding right-of-use asset, whereas these leases currently have an off-balance sheet classification. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. The Company currently intends to adopt this standard in the first quarter of fiscal 2019 and expects to elect certain practical expedients permitted under the transition guidance, including the package of practical expedients; however, the Company does not intend to elect the hindsight practical expedient. Additionally, the Company will elect the optional transition method that allows for a cumulative-effect adjustment in the period of adoption and will not restate prior periods. In fiscal 2018, the Company implemented a new lease system to assist with its compliance with ASU 2016-02 in fiscal 2019, and has a project team focused on identifying a complete population of leases, evaluating accounting policy elections, and establishing new processes and internal controls. The Company is still evaluating the impact of implementation of this standard on its financial statements, but expects that adoption will have a material impact to the Company's total assets and liabilities given the Company has a significant number of operating leases not currently recognized on its balance sheet. However, this standard is not expected to have a material impact on the consolidated statement of operations or the consolidated statement of cash flows.

Table of Contents

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory, which requires entities to recognize the income tax effects of intercompany sales and transfers of assets, other than inventory, in the period in which the transfer occurs. This is a change from current GAAP, which requires entities to defer the income tax effects of intercompany transfers of assets until the asset has been sold to an outside party or otherwise recognized (i.e. depreciated, amortized, impaired). The income tax effects of intercompany sales and transfers of inventory will continue to be deferred until the inventory is sold to an outside party. This ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those years, with early adoption permitted. The Company adopted ASU 2016-16 in the first quarter of fiscal 2018. The adoption of this standard did not result in a material impact to the Company's financial statements.

In March 2017, the FASB issued ASU 2017-07, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which provides guidance that requires an employer to present the service cost component separate from the other components of net periodic benefit cost. The update requires that employers present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered by participating employees during the period. The other components of the net periodic benefit cost are required to be presented separately from the line item that includes service cost and outside of the subtotal of income from operations. If a separate line item is not used, the line item used in the income statement must be disclosed. In addition, only the service cost component is eligible for capitalization in assets. The Company adopted ASU 2017-07 in the first quarter of fiscal 2018 on a retrospective basis. The adoption of this standard did not result in a material impact to the Company's financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting, which clarifies when modification accounting should be applied for changes to terms or conditions of a share-based payment award. The Company adopted ASU 2017-09 in the first quarter of fiscal 2018 on a prospective basis. The adoption of this standard did not result in a material impact to the Company's financial statements.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, which is intended to improve and simplify hedge accounting and improve the disclosures of hedging arrangements. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The adoption of this standard is not expected to result in a material impact to the Company's financial statements.

In June 2018, the FASB issued ASU 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which simplifies the accounting for share-based payments granted to nonemployees for goods and services. Under this ASU, the guidance on share-based payments to nonemployees would be aligned with the requirements for share-based payments granted to employees, with certain exceptions. This ASU is effective for fiscal years beginning after December 15, 2018, and interim periods within those years, with

early adoption permitted. The Company is currently evaluating the impact of adopting the new standard on its financial statements, but does not expect it to have a material impact to the financial statements.

In August 2018, the FASB issued ASU 2018-15, Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract, which requires a customer in a cloud computing arrangement that is a service contract to follow the internal-use software guidance in Accounting Standards Codification (“ASC”) 350-40 to determine which implementation costs to capitalize as assets. A customer’s accounting for the costs of the hosting component of the arrangement are not affected by the new guidance. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted. The adoption of this standard is not expected to result in a material impact to the Company’s financial statements.

Table of Contents

2. Detail of certain balance sheet accounts

| | December 29, 2018 | March 31, 2018 | December 30, 2017 |
|--|----------------------|-------------------|----------------------|
| Accounts receivable, net: | | | |
| Trade receivables, net | \$ 15,150 | \$ 15,968 | \$ 14,934 |
| Credit card receivables | 10,407 | 6,939 | 11,221 |
| Tenant allowances | 2,186 | 998 | 1,681 |
| Other receivables | 1,806 | 1,623 | 1,712 |
| | \$ 29,549 | \$ 25,528 | \$ 29,548 |
| Inventory: | | | |
| Finished goods | \$ 110,769 | \$ 91,970 | \$ 104,714 |
| Raw materials | 4,762 | 4,840 | 5,139 |
| Work in progress | 475 | 552 | 538 |
| | \$ 116,006 | \$ 97,362 | \$ 110,391 |
| Accrued liabilities: | | | |
| Accrued payroll, benefits and bonuses | \$ 21,406 | \$ 23,833 | \$ 25,847 |
| Unearned revenue | 10,941 | 11,080 | 10,197 |
| Accrued transaction and property tax | 9,767 | 12,846 | 12,621 |
| Gift cards and store credits outstanding | 9,562 | 8,891 | 9,984 |
| Accrued lease liabilities | 4,793 | 5,105 | 6,329 |
| Accrued interest | 1,844 | 292 | 156 |
| Other accrued liabilities | 9,395 | 8,447 | 8,405 |
| | \$ 67,708 | \$ 70,494 | \$ 73,539 |

3. Long-term debt and revolving lines of credit

On September 14, 2018 (the “Effective Date”), the Company entered into a fifth amendment (the “Fifth Amendment”) to the Credit Agreement dated as of April 6, 2012 (“Senior Secured Term Loan Facility”). The Fifth Amendment amended the Senior Secured Term Loan Facility to, among other things, (i) extend the maturity date of the loans under the Senior Secured Term Loan Facility to September 14, 2023, (ii) decrease the applicable interest rate margin to 5.00% for LIBOR loans and 4.00% for base rate loans and, beginning from the date that a compliance certificate is delivered to the administrative agent for the fiscal year ending March 30, 2019, allow the applicable interest rate margin to step down to 4.75% for LIBOR loans and 3.75% for base rate loans upon achievement of a consolidated leverage ratio equal to or less than 2.75:1.00, and (iii) impose a 1.00% premium if a voluntary prepayment is made from the proceeds of a repricing transaction within 12 months after the Effective Date.

In connection with the Fifth Amendment, the Company repaid \$20,000 of the outstanding loans under the Senior Secured Term Loan Facility, which reduced the aggregate principal amount of the Senior Secured Term Loan Facility

to \$272,500. The Company drew down a net amount of approximately \$10,000 on its \$100,000 asset-based revolving credit agreement (the “Revolving Credit Facility”) in connection with the closing of the Fifth Amendment. In addition, the Company recorded a loss on extinguishment of debt of \$2,082 in the thirteen weeks ended September 29, 2018 associated with the Fifth Amendment.

The Company capitalizes certain costs associated with issuance of various debt instruments. These deferred financing costs are amortized to interest expense on a straight-line method, which is materially consistent with the effective interest method, over the terms of the related debt agreements. In the thirty-nine weeks ended December 29, 2018, the Company capitalized \$2,384 of fees associated with the Fifth Amendment which will be amortized through September 14, 2023.

Table of Contents

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

| | December 29, 2018 | March 31, 2018 | December 30, 2017 |
|-------------------------------------|----------------------|-------------------|----------------------|
| Senior secured term loan facility | \$ 270,797 | \$ 294,375 | \$ 296,250 |
| 2014 Elfa term loan facility | — | — | 2,569 |
| 2014 Elfa revolving credit facility | — | — | — |
| Obligations under capital leases | 474 | 662 | 865 |
| Other loans | — | 16 | 49 |
| Revolving credit facility | 42,000 | — | 25,000 |
| Total debt | 313,271 | 295,053 | 324,733 |
| Less current portion | (7,018) | (7,771) | (9,465) |
| Less deferred financing costs (1) | (8,358) | (9,888) | (10,630) |
| Total long-term debt | \$ 297,895 | \$ 277,394 | \$ 304,638 |

(1) Represents deferred financing costs related to our Senior Secured Term Loan Facility, which are presented net of long-term debt in the consolidated balance sheet.

4. Net income per common share

Basic net income per common share is computed as net income divided by the weighted-average number of common shares for the period. Diluted net income per share is computed as net income divided by the weighted-average number of common shares for the period plus common stock equivalents consisting of shares subject to stock-based awards with exercise prices less than or equal to the average market price of the Company's common stock for the period, to the extent their inclusion would be dilutive. Potentially dilutive securities are excluded from the computation of diluted net income per share if their effect is anti-dilutive.

The following is a reconciliation of net income and the number of shares used in the basic and diluted net income per share calculations:

| Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|----------------------|--------------|-------------------------|--------------|
| December 29, | December 30, | December 29, | December 30, |

Edgar Filing: Container Store Group, Inc. - Form 10-Q

| | 2018 | 2017 | 2018 | 2017 |
|---|------------|------------|------------|------------|
| Numerator: | | | | |
| Net income | \$ 9,321 | \$ 28,379 | \$ 5,798 | \$ 19,827 |
| Denominator: | | | | |
| Weighted-average common shares — basic | 48,139,582 | 48,067,754 | 48,139,132 | 48,057,974 |
| Options and other dilutive securities | 241,873 | 100,128 | 268,205 | 70,708 |
| Weighted-average common shares — diluted | 48,381,455 | 48,167,882 | 48,407,337 | 48,128,682 |
| Net income per common share — basic and diluted | \$ 0.19 | \$ 0.59 | \$ 0.12 | \$ 0.41 |
| Antidilutive securities not included: | | | | |
| Stock options outstanding | 2,408,068 | 3,157,843 | 2,450,246 | 3,016,359 |
| Nonvested restricted stock awards | 148,310 | 42,541 | 29,251 | 40,643 |

5. Income taxes

The benefit for income taxes in the thirteen weeks ended December 29, 2018 was \$3,926 as compared to a benefit of \$21,780 in the thirteen weeks ended December 30, 2017. The effective tax rate for the thirteen weeks ended December 29, 2018 was -72.8%, as compared to -330.1% in the thirteen weeks ended December 30, 2017. During the thirteen weeks ended December 29, 2018, the effective tax rate fell below the U.S statutory rate primarily due to the finalization of the one-time transition tax on foreign earnings related to the Tax Cuts and Jobs Act (the “Tax Act”)

Table of Contents

enacted in fiscal 2017. During the thirteen weeks ended December 30, 2017, the effective tax rate fell below the blended U.S. statutory rate of 31.5% primarily due to the estimated impact of the Tax Act, which was primarily driven by the remeasurement of deferred tax balances.

The Company's effective income tax rate for the thirty-nine weeks ended December 29, 2018 was 3135.6% compared to 429.3% for the thirty-nine weeks ended December 30, 2017. During the thirty-nine weeks ended December 29, 2018, the effective tax rate rose above the U.S. statutory rate due to the finalization of the one-time transition tax on foreign earnings and other Tax Act items, and recognition of a \$604 tax benefit for the remeasurement of deferred tax balances as a result of a change in the Swedish tax rate, combined with a year-to-date pre-tax loss. During the thirty-nine weeks ended December 30, 2017, the effective tax rate rose above the blended U.S. statutory rate of 31.5% primarily due to the estimated impact of the Tax Act, which was primarily driven by the remeasurement of deferred tax balances.

Tax Cuts and Jobs Act

Pursuant to Staff Accounting Bulletin ("SAB") No. 118 ("SAB 118"), the Company's measurement period for implementing the accounting changes required by the Tax Act closed on December 22, 2018 and the Company completed the accounting under ASC Topic 740, Income Taxes ("ASC 740") in the third quarter of fiscal 2018.

In the fourth quarter of fiscal 2017, the Company recorded a provisional expense of \$8,521 related to the one-time transition tax on foreign earnings. Upon further analysis of certain aspects of the Tax Act and refinement of its calculations, the Company recorded a benefit of \$5,903 in the third quarter of fiscal 2018, which is included as a component of income tax benefit in the consolidated statement of operations, related to the one-time transition tax on foreign earnings. The final calculated one-time transition tax on foreign earnings is \$2,618 which is net of foreign tax credit utilization of \$833. Additionally, the Company has \$1,331 of foreign tax credits which it does not expect to utilize to offset future foreign taxable income. As such, the Company has recorded a full valuation allowance related to these credits, the effect of which is included within the net transition tax liability. As of December 29, 2018, the Company has a remaining transition tax liability of \$1,819, which will be paid in installments over the next seven years as elected.

As of December 30, 2017, the Company remeasured deferred tax assets and liabilities based on the rates at which they were expected to reverse in the future, which was generally 21%, by recording a provisional benefit of \$24,210. Upon further analysis of certain aspects of the Tax Act and refinement of its calculations, the Company adjusted its provisional amount by \$224 of tax expense in the thirty-nine weeks ended December 29, 2018, which is included as a component of income tax benefit in the consolidated statement of operations. The final net impact related to the remeasurement of deferred tax assets and liabilities pursuant to the Tax Act is a benefit of \$23,986.

The Tax Act creates a new requirement that certain global intangible low-taxed income (“GILTI”) earned by controlled foreign corporations (“CFC”) must be included currently in the taxable income of the CFC’s U.S. shareholder. The Company became subject to the GILTI provisions beginning in fiscal 2018. The Company has elected an accounting policy to recognize GILTI as a period cost when incurred.

6. Commitments and contingencies

In connection with insurance policies and other contracts, the Company has outstanding standby letters of credit totaling \$3,826 as of December 29, 2018.

The Company is subject to ordinary litigation and routine reviews by regulatory bodies that are incidental to its business, none of which is expected to have a material adverse effect on the Company’s financial condition, results of operations, or cash flows on an individual basis or in the aggregate.

Table of Contents

7. Accumulated other comprehensive loss

Accumulated other comprehensive loss (“AOCL”) consists of changes in our foreign currency forward contracts, pension liability adjustment, and foreign currency translation. The components of AOCL, net of tax, are shown below for the thirty-nine weeks ended December 29, 2018:

| | Foreign currency hedge instruments | Pension liability adjustment | Foreign currency translation | Total |
|--|---|------------------------------------|------------------------------------|-------------|
| Balance at March 31, 2018 | \$ (102) | \$ (1,793) | \$ (15,421) | \$ (17,316) |
| Other comprehensive (loss) income before reclassifications, net of tax | (1,408) | 132 | (4,775) | (6,051) |
| Amounts reclassified to earnings, net of tax | 721 | — | — | 721 |
| Net current period other comprehensive (loss) income | (687) | 132 | (4,775) | (5,330) |
| Balance at December 29, 2018 | \$ (789) | \$ (1,661) | \$ (20,196) | \$ (22,646) |

Amounts reclassified from AOCL to earnings for the foreign currency forward contracts category are generally included in cost of sales in the Company’s consolidated statements of operations. For a description of the Company’s use of foreign currency forward contracts, refer to Note 8.

8. Foreign currency forward contracts

The Company’s international operations and purchases of inventory products from foreign suppliers are subject to certain opportunities and risks, including foreign currency fluctuations. In the TCS segment, we utilize foreign currency forward contracts in Swedish krona to stabilize our retail gross margins and to protect our domestic operations from downward currency exposure by hedging purchases of inventory from our wholly-owned subsidiary, Elfa. Forward contracts in the TCS segment are designated as cash flow hedges, as defined by ASC 815. In the Elfa segment, we utilize foreign currency forward contracts to hedge purchases, primarily of raw materials, that are transacted in currencies other than Swedish krona, which is the functional currency of Elfa. Forward contracts in the Elfa segment are economic hedges and are not designated as cash flow hedges as defined by ASC 815.

During the thirty-nine weeks ended December 29, 2018 and December 30, 2017, the TCS segment used forward contracts for 97% and 100% of inventory purchases in Swedish krona, respectively. During the thirty-nine weeks ended December 29, 2018 and December 30, 2017, the Elfa segment used forward contracts to purchase U.S. dollars

in the amount of \$0 and \$1,648, which represented 0% and 27% of the Elfa segment's U.S. dollar purchases, respectively. Generally, the Company's foreign currency forward contracts have terms from 1 to 12 months and require the Company to exchange currencies at agreed-upon rates at settlement.

The counterparties to the contracts consist of a limited number of major domestic and international financial institutions. The Company does not hold or enter into financial instruments for trading or speculative purposes. The Company records its foreign currency forward contracts on a gross basis and generally does not require collateral from these counterparties because it does not expect any losses from credit exposure.

The Company records all foreign currency forward contracts on its consolidated balance sheet at fair value. The Company accounts for its foreign currency hedging instruments in the TCS segment as cash flow hedges, as defined. Changes in the fair value of the foreign currency hedging instruments that are considered to be effective, as defined, are recorded in other comprehensive income (loss) until the hedged item (inventory) is sold to the customer, at which time the deferred gain or loss is recognized through cost of sales. Any portion of a change in the foreign currency hedge instrument's fair value that is considered to be ineffective, as defined, or that the Company has elected to exclude from its measurement of effectiveness, is immediately recorded in earnings as cost of sales. The Company assessed the effectiveness of the foreign currency hedge instruments and determined the foreign currency hedge instruments were highly effective during the thirty-nine weeks ended December 29, 2018 and December 30, 2017. Forward contracts not

Table of Contents

designated as hedges in the Elfa segment are adjusted to fair value as SG&A expenses on the consolidated statements of operations; however, during the thirty-nine weeks ended December 29, 2018, the Company did not recognize any amount associated with the change in fair value of forward contracts not designated as hedging instruments, as the Company had none of these instruments outstanding.

The Company had a \$789 loss in accumulated other comprehensive loss related to foreign currency hedge instruments at December 29, 2018, of which \$740 represents an unrealized loss for settled foreign currency hedge instruments related to inventory on hand as of December 29, 2018. The Company expects the unrealized loss of \$740, net of taxes, to be reclassified into earnings over the next 12 months as the underlying inventory is sold to the end customer.

The change in fair value of the Company's foreign currency hedge instruments that qualify as cash flow hedges and are included in accumulated other comprehensive loss, net of taxes, are presented in Note 7 of these financial statements.

9. Fair value measurements

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

- Level 1—Valuation inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.
- Level 2—Valuation inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Valuation inputs are unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are determined using model-based techniques that include option pricing models, discounted cash flow models and similar techniques.

As of December 29, 2018, March 31, 2018 and December 30, 2017, the Company held certain items that are required to be measured at fair value on a recurring basis. These included the nonqualified retirement plan and foreign currency

forward contracts. The nonqualified retirement plan consists of investments purchased by employee contributions to retirement savings accounts. The Company's foreign currency hedging instruments consist of over-the-counter (OTC) contracts, which are not traded on a public exchange. See Note 8 for further information on the Company's hedging activities.

The fair values of the nonqualified retirement plan and foreign currency forward contracts are determined based on the market approach which utilizes inputs that are readily available in public markets or can be derived from information available in publicly quoted markets for comparable assets. Therefore, the Company has categorized these items as Level 2. The Company also considers counterparty credit risk and its own credit risk in its determination of all estimated fair values. The Company has consistently applied these valuation techniques in all periods presented and believes it has obtained the most accurate information available for the types of contracts it holds.

Table of Contents

The following items are measured at fair value on a recurring basis, subject to the disclosure requirements of ASC 820, Fair Value Measurements:

| Description | | Balance Sheet Location | December 29, 2018 | March 31, 2018 | December 30, 2017 |
|------------------------------------|---------|------------------------|----------------------|-------------------|----------------------|
| Assets | | | | | |
| Nonqualified retirement plan (1) | N/A | Other current assets | \$ 5,156 | \$ 5,848 | \$ 5,782 |
| Foreign currency forward contracts | Level 2 | Other current assets | 35 | — | — |
| Total assets | | | \$ 5,191 | \$ 5,848 | \$ 5,782 |

(1) The fair value amount of the nonqualified retirement plan is measured at fair value using the net asset value per share practical expedient, and therefore, is not classified in the fair value hierarchy.

The fair value of long-term debt was estimated using quoted prices as well as recent transactions for similar types of borrowing arrangements (Level 2 valuations). As of December 29, 2018, March 31, 2018 and December 30, 2017, the estimated fair value of the Company's long-term debt, including current maturities, was \$292,961, \$295,605, and \$313,068, respectively.

10. Segment reporting

The Company's reportable segments were determined on the same basis as how management evaluates performance internally by the Chief Operating Decision Maker ("CODM"). The Company has determined that the Chief Executive Officer is the CODM and the Company's two reportable segments consist of TCS and Elfa. The TCS segment includes the Company's retail stores, website and call center, as well as the installation and organization services business.

The Elfa segment includes the manufacturing business that produces the elfa® brand products that are sold domestically exclusively through the TCS segment, as well as on a wholesale basis in approximately 30 countries around the world with a concentration in the Nordic region of Europe. The intersegment sales in the Elfa column represent elfa® product sales to the TCS segment. These sales and the related gross margin on merchandise recorded in TCS inventory balances at the end of the period are eliminated for consolidation purposes in the Eliminations column. The net sales to third parties in the Elfa column represent sales to customers outside of the United States.

The Company has determined that adjusted earnings before interest, tax, depreciation, and amortization ("Adjusted EBITDA") is the profit or loss measure that the CODM uses to make resource allocation decisions and evaluate segment performance.

Adjusted EBITDA assists management in comparing our performance on a consistent basis for purposes of business decision-making by removing the impact of certain items that management believes do not directly reflect our core operations and, therefore, are not included in measuring segment performance. Adjusted EBITDA is calculated in accordance with the Senior Secured Term Loan Facility and the Revolving Credit Facility and we define Adjusted EBITDA as net income before interest, taxes, depreciation and amortization, certain non-cash items, and other adjustments that we do not consider in our evaluation of ongoing operating performance from period to period.

| Thirteen weeks ended December 29, 2018 | TCS | Elfa | Eliminations | Total |
|--|------------|-----------|--------------|------------|
| Net sales to third parties | \$ 204,899 | \$ 16,738 | \$ — | \$ 221,637 |
| Intersegment sales | — | 22,369 | (22,369) | — |
| Adjusted EBITDA | 19,014 | 4,994 | (2,192) | 21,816 |
| Interest expense, net | 5,957 | 51 | — | 6,008 |
| Assets (1) | 671,865 | 105,491 | (5,334) | 772,022 |

Table of Contents

| Thirteen weeks ended December 30, 2017 | TCS | Elfa | Eliminations | Total |
|--|------------|-----------|--------------|------------|
| Net sales to third parties | \$ 203,881 | \$ 19,105 | \$ — | \$ 222,986 |
| Intersegment sales | — | 23,495 | (23,495) | — |
| Adjusted EBITDA | 22,550 | 6,374 | (3,363) | 25,561 |
| Interest expense, net | 7,232 | 68 | — | 7,300 |
| Assets (1) | 673,489 | 116,779 | (5,869) | 784,399 |

| Thirty-nine weeks ended December 29, 2018 | TCS | Elfa | Eliminations | Total |
|---|------------|-----------|--------------|------------|
| Net sales to third parties | \$ 593,896 | \$ 48,017 | \$ — | \$ 641,913 |
| Intersegment sales | — | 47,414 | (47,414) | — |
| Adjusted EBITDA | 50,345 | 10,432 | (2,223) | 58,554 |
| Interest expense, net | 21,097 | 196 | — | 21,293 |
| Assets (1) | 671,865 | 105,491 | (5,334) | 772,022 |

| Thirty-nine weeks ended December 30, 2017 | TCS | Elfa | Eliminations | Total |
|---|------------|-----------|--------------|------------|
| Net sales to third parties | \$ 573,261 | \$ 51,203 | \$ — | \$ 624,464 |
| Intersegment sales | — | 46,036 | (46,036) | — |
| Adjusted EBITDA | 51,760 | 10,965 | (4,218) | 58,507 |
| Interest expense, net | 17,189 | 209 | — | 17,398 |
| Assets (1) | 673,489 | 116,779 | (5,869) | 784,399 |

(1) Tangible assets in the Elfa column are located outside of the United States.

A reconciliation of income (loss) before taxes to Adjusted EBITDA is set forth below:

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|-------------------------------------|----------------------|-------------------|-------------------------|-------------------|
| | December 29, 2018 | December 30, 2017 | December 29, 2018 | December 30, 2017 |
| Income (loss) before taxes | \$ 5,395 | \$ 6,599 | \$ (191) | \$ (6,021) |
| Add: | | | | |
| Depreciation and amortization | 8,887 | 9,477 | 27,352 | 28,524 |
| Interest expense, net | 6,008 | 7,300 | 21,293 | 17,398 |
| Pre-opening costs (a) | 691 | 1,872 | 1,918 | 4,676 |
| Non-cash rent (b) | 101 | (714) | (1,117) | (1,451) |
| Stock-based compensation (c) | 632 | 585 | 1,987 | 1,589 |
| Loss on extinguishment of debt (d) | — | — | 2,082 | 2,369 |
| Foreign exchange losses (gains) (e) | 22 | (360) | 69 | (306) |
| | — | 422 | 4,864 | 10,742 |

Edgar Filing: Container Store Group, Inc. - Form 10-Q

Optimization Plan implementation charges

| | | | | |
|---|-----------|-----------|-----------|-----------|
| (f) | | | | |
| Elfa manufacturing facility closure (g) | — | 335 | — | 852 |
| Other adjustments (h) | 80 | 45 | 297 | 135 |
| Adjusted EBITDA | \$ 21,816 | \$ 25,561 | \$ 58,554 | \$ 58,507 |

- (a) Non-capital expenditures associated with opening new stores and relocating stores, including rent, marketing expenses, travel and relocation costs, and training costs. We adjust for these costs to facilitate comparisons of our performance from period to period.
- (b) Reflects the extent to which our annual GAAP rent expense has been above or below our cash rent payment due to lease accounting adjustments. The adjustment varies depending on the average age of our lease portfolio (weighted for size), as our GAAP rent expense on younger leases typically exceeds our cash cost, while our GAAP rent expense on older leases is typically less than our cash cost.
- (c) Non-cash charges related to stock-based compensation programs, which vary from period to period depending on volume and vesting timing of awards. We adjust for these charges to facilitate comparisons from period to period.

Table of Contents

- (d) Loss recorded as a result of the amendments made to the Senior Secured Term Loan Facility in September 2018 and the amendments made to the Senior Secured Term Loan Facility and the Revolving Credit Facility in August 2017, which we do not consider in our evaluation of our ongoing operations.
- (e) Realized foreign exchange transactional gains/losses our management does not consider in our evaluation of our ongoing operations.
- (f) Charges incurred to implement our Optimization Plan, which include certain consulting costs recorded in SG&A expenses in the first quarter of fiscal 2018 and in fiscal 2017, cash severance payments associated with the elimination of certain full-time positions at the TCS segment recorded in other expenses in fiscal 2017, and cash severance payments associated with organizational realignment at the Elfa segment recorded in other expenses in fiscal 2017, which we do not consider in our evaluation of ongoing performance.
- (g) Charges related to the closure of an Elfa manufacturing facility in Lahti, Finland in December 2017, recorded in other expenses, which we do not consider in our evaluation of our ongoing performance.
- (h) Other adjustments include amounts our management does not consider in our evaluation of our ongoing operations, including certain severance and other charges.

11. Subsequent Event

On January 24, 2019, as part of its ongoing long-term succession planning, the Company announced that Melissa Reiff, Chief Executive Officer, will succeed William A. “Kip” Tindell, III as Chairman of the Board effective as of the conclusion of the Company’s 2019 Annual Meeting of Shareholders (the “2019 Annual Meeting”).

The Company also announced that Sharon Tindell, President and Chief Merchandising Officer, will retire from her role as President and Chief Merchandising Officer at the conclusion of the 2019 Annual Meeting. At that time, John Gehre, who joined The Container Store in June 2018 as Executive Vice President of Merchandising and Planning, will succeed Ms. Tindell as the Company’s Chief Merchandising Officer, and Melissa Reiff will add President to her title. In addition, the Company announced that Jodi Taylor will continue to serve as the Company’s Chief Financial Officer, Chief Administrative Officer and Secretary until a mutually agreed upon date after March 1, 2020 but before September 1, 2020, at which point she will no longer serve as the Company’s Chief Financial Officer and a successor Chief Financial Officer will be named, but Ms. Taylor will continue to serve as the Company’s Chief Administrative Officer and Secretary.

In connection with the management changes described above, the Company entered into amended and restated employment agreements on January 23, 2019 with Ms. Reiff, Ms. Tindell, and Ms. Taylor.

Each of the employment agreements continue to provide for annual grants of equity awards subject to the Company's 2013 Incentive Award Plan and award agreements thereunder.

Each employment agreement was modified to provide that (i) upon a termination of employment by the Company without Cause (as defined in the applicable employment agreement), by the executive for Good Reason (as defined in the applicable employment agreement), or due to death or Disability (as defined in the applicable employment agreement), all equity awards subject to solely service-based vesting (rather than only stock options and performance-based restricted shares for which the performance period has ended) will vest (intended to reflect changes in the types of equity awards that have been granted by the Company recently), (ii) in the event of a termination of employment by the Company without Cause or by the executive for Good Reason within the two years following the date of a Change in Control (as defined in the applicable employment agreement), all restricted share awards subject to performance-based vesting with ongoing performance periods will fully vest in the amount that would have otherwise vested if the performance targets underlying such equity awards had been achieved at maximum levels, and (iii) upon a termination of employment due to expiration of the term, each executive will receive (a) in the case of Ms. Reiff and Ms. Taylor, severance that is substantially similar to that which such executive would receive in the event of a termination of

Table of Contents

employment by the Company without Cause or by the executive for Good Reason outside the Change in Control Context, with the exception that the severance multiple of annual base salary and annual bonus will be one rather than two, and (b) in the case of Ms. Tindell, accelerated vesting of the portion of Ms. Tindell's outstanding performance-based restricted share award granted on July 1, 2016 that is scheduled to time-vest on April 1, 2020 (in the amount determined based on actual performance).

Table of Contents

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

Cautionary note regarding forward-looking statements

This report, including this Management’s Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In some cases, you can identify forward-looking statements by terms such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “potential” or “contingent,” and the negative of these terms or other similar expressions. The forward-looking statements included in this Quarterly Report, including without limitation statements regarding expectations for our business, anticipated financial performance and liquidity, anticipated interest expense, and expectations regarding our Optimization Plan, are only predictions and involve known and unknown risks, uncertainties and other important factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. These include, but are not limited to: a decline in the health of the economy and the purchase of discretionary items; risks related to new store openings; our inability to source and market our products to meet customer preferences or inability to offer customers an aesthetically pleasing shopping environment; the risk that our operating and financial performance in a given period will not meet the guidance we provided to the public; the risk that significant business initiatives may not be successful; our dependence on a single distribution center for all of our stores; risks related to opening a second distribution center; our reliance on third-party web service providers; the vulnerability of our facilities and systems to natural disasters and other unexpected events; risks related to our reliance on independent third-party transportation providers for substantially all of our product shipments; our dependence on our brand image and any inability to protect our brand; our failure to successfully anticipate consumer demand and manage inventory commensurate with demand; our failure to effectively manage our growth; our inability to lease space on favorable terms; fluctuations in currency exchange rates; risks related to a security breach or cyber-attack of our website or information technology systems, and other damage to such systems; our inability to effectively manage online sales; effects of competition on our business; risks related to our inability to obtain capital on satisfactory terms or at all; disruptions in the global financial markets leading to difficulty in borrowing sufficient amounts of capital to finance the carrying costs of inventory to pay for capital expenditures and operating costs; our inability to obtain merchandise from our vendors on a timely basis and at competitive prices; the risk that our vendors may sell their products to our competitors; our dependence on key executive management, and the transition in our executive leadership; our inability to find, train and retain key personnel; labor activities and unrest; rising health care and labor costs; risks associated with our dependence on foreign imports; risks related to violations of anti-bribery and anti-kickback laws; risks related to our indebtedness; risks related to our fixed lease obligations; material damage to or interruptions in our information technology systems; risks related to litigation; product recalls and/or product liability and changes in product safety and consumer protection laws; changes in statutory, regulatory, accounting and other legal requirements; risks related to changes in estimates or projections used to assess the fair value of our intangible assets; impacts to our business as a result of the Tax Cuts and Jobs Act; seasonal fluctuations in our operating results; material disruptions in one of our Elfa manufacturing facilities; our inability to protect our intellectual property rights and claims that we have infringed third parties’ intellectual property rights; risks related to our status as a controlled company; significant fluctuations in the price of our common stock; substantial future sales of our common stock, or the perception that such sales may occur, which could depress the price of our common stock; risks related to being a public company; anti-takeover provisions

in our governing documents, which could delay or prevent a change in control; reduced disclosure requirements applicable to emerging growth companies, which could make our stock less attractive to investors; and our failure to establish and maintain effective internal controls. Other important risk factors that could affect the outcome of the events set forth in these statements and that could affect our operating results and financial condition are described in the “Risk Factors” section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the Securities and Exchange Commission (the “SEC”) on May 31, 2018.

We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. These forward-looking statements speak only as of the date of this report. Because forward-looking statements are inherently subject to risks and uncertainties, you should not rely on these forward-looking statements as predictions of future

Table of Contents

events. Except as required by applicable law, we do not plan to publicly update or revise any forward-looking statements contained herein after the date of this report, whether as a result of any new information, future events or otherwise.

Unless the context otherwise requires, references in this Quarterly Report on Form 10-Q to the “Company,” “we,” “us,” and “our” refer to The Container Store Group, Inc. and, where appropriate, its subsidiaries.

We follow a 4-4-5 fiscal calendar, whereby each fiscal quarter consists of thirteen weeks grouped into two four-week “months” and one five-week “month”, and our fiscal year is the 52- or 53-week period ending on the Saturday closest to March 31. Fiscal 2018 ends on March 30, 2019 and fiscal 2017 ended on March 31, 2018. The third quarter of fiscal 2018 ended on December 29, 2018 and the third quarter of fiscal 2017 ended on December 30, 2017, and both included thirteen weeks.

Overview

The Container Store® is the original and leading specialty retailer of storage and organization products and solutions in the United States and the only national retailer solely devoted to the category. We provide a collection of creative, multifunctional and customizable storage and organization solutions that are sold in our stores and online through a high-service, differentiated shopping experience. Our vision is to be a beloved brand and the first choice for customized organization solutions and services. Our customers are highly educated, very busy and primarily homeowners with a higher than average household income. We service them with storage and organization solutions that help them accomplish projects, maximize their space, and make the most of their home.

Our operations consist of two operating segments:

The Container Store (“TCS”), which consists of our retail stores, website and call center, as well as our installation and organizational services business. As of December 29, 2018, we operated 92 stores with an average size of approximately 25,000 square feet (19,000 selling square feet) in 33 states and the District of Columbia. We allow our customers to shop with us in a variety of ways—anywhere, anytime, any way they want through a multi-channel shopping experience. Our stores receive substantially all of our products directly from our distribution center co-located with our corporate headquarters and call center in Coppell, Texas.

Elfa, The Container Store, Inc.’s wholly-owned Swedish subsidiary, Elfa International AB (“Elfa”), which designs and manufactures component-based shelving and drawer systems and made-to-measure sliding doors. Elfa was founded in 1948 and is headquartered in Malmö, Sweden. Elfa’s shelving and drawer systems are customizable for any area of the

home, including closets, kitchens, offices and garages. Elfa operates three manufacturing facilities with two located in Sweden and one in Poland. The Container Store began selling elfa® products in 1978 and acquired Elfa in 1999. Today our TCS segment is the exclusive distributor of elfa® products in the U.S. Elfa also sells its products on a wholesale basis to various retailers in approximately 30 countries around the world, with a concentration in the Nordic region of Europe.

Optimization Plan

As previously announced in fiscal 2017, we launched a four-part optimization plan to drive improved sales and profitability (the “Optimization Plan”). This plan includes sales initiatives, certain full-time position eliminations at TCS, organizational realignment at Elfa and ongoing savings and efficiency efforts.

In fiscal 2018, we expect to complete the Optimization Plan through the execution of a price optimization initiative. The price optimization initiative is designed to maximize sales and gross profit. We incurred approximately \$4.9 million of pre-tax charges associated with the implementation of the price optimization initiative in the first quarter of fiscal 2018 and do not currently expect to incur additional costs for the Optimization Plan in the remainder of fiscal 2018.

Table of Contents

Note on Dollar Amounts

All dollar amounts in this Management's Discussion and Analysis of Financial Condition and Results of Operations are in thousands, except per share amounts and unless otherwise stated.

Results of Operations

The following data represents the amounts shown in our unaudited consolidated statements of operations expressed in dollars and as a percentage of net sales and operating data for the periods presented. For segment data, see Note 10 to our unaudited consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|---|----------------------|-------------------|-------------------------|-------------------|
| | December 29, 2018 | December 30, 2017 | December 29, 2018 | December 30, 2017 |
| Net sales | \$ 221,637 | \$ 222,986 | \$ 641,913 | \$ 624,464 |
| Cost of sales (excluding depreciation and amortization) | 91,580 | 92,425 | 266,510 | 263,919 |
| Gross profit | 130,057 | 130,561 | 375,403 | 360,545 |
| Selling, general, and administrative expenses (excluding depreciation and amortization) | 108,688 | 103,894 | 320,949 | 306,866 |
| Stock-based compensation | 632 | 585 | 1,987 | 1,589 |
| Pre-opening costs | 691 | 1,872 | 1,918 | 4,676 |
| Depreciation and amortization | 8,887 | 9,477 | 27,352 | 28,524 |
| Other expenses | 80 | 751 | 297 | 4,908 |
| (Gain) loss on disposal of assets | (324) | 83 | (284) | 236 |
| Income from operations | 11,403 | 13,899 | 23,184 | 13,746 |
| Interest expense, net | 6,008 | 7,300 | 21,293 | 17,398 |
| Loss on extinguishment of debt | — | — | 2,082 | 2,369 |
| Income (loss) before taxes | 5,395 | 6,599 | (191) | (6,021) |
| Benefit for income taxes | (3,926) | (21,780) | (5,989) | (25,848) |
| Net income | \$ 9,321 | \$ 28,379 | \$ 5,798 | \$ 19,827 |

Table of Contents

| | Thirteen Weeks Ended | | | | Thirty-Nine Weeks Ended | | | |
|---|----------------------|---|-------------------|---|-------------------------|---|-------------------|---|
| | December 29, 2018 | | December 30, 2017 | | December 29, 2018 | | December 30, 2017 | |
| Percentage of net sales: | | | | | | | | |
| Net sales | 100.0 | % | 100.0 | % | 100.0 | % | 100.0 | % |
| Cost of sales (excluding depreciation and amortization) | 41.3 | % | 41.4 | % | 41.5 | % | 42.3 | % |
| Gross profit | 58.7 | % | 58.6 | % | 58.5 | % | 57.7 | % |
| Selling, general, and administrative expenses (excluding depreciation and amortization) | 49.0 | % | 46.6 | % | 50.0 | % | 49.1 | % |
| Stock based compensation | 0.3 | % | 0.3 | % | 0.3 | % | 0.3 | % |
| Pre opening costs | 0.3 | % | 0.8 | % | 0.3 | % | 0.7 | % |
| Depreciation and amortization | 4.0 | % | 4.3 | % | 4.3 | % | 4.6 | % |
| Other expenses | 0.0 | % | 0.3 | % | 0.0 | % | 0.8 | % |
| (Gain) loss on disposal of assets | (0.1) | % | 0.0 | % | (0.0) | % | 0.0 | % |
| Income from operations | 5.1 | % | 6.2 | % | 3.6 | % | 2.2 | % |
| Interest expense, net | 2.7 | % | 3.3 | % | 3.3 | % | 2.8 | % |
| Loss on extinguishment of debt | — | % | — | % | 0.3 | % | 0.4 | % |
| Income (loss) before taxes | 2.4 | % | 3.0 | % | (0.0) | % | (1.0) | % |
| Benefit for income taxes | (1.8) | % | (9.8) | % | (0.9) | % | (4.1) | % |
| Net income | 4.2 | % | 12.7 | % | 0.9 | % | 3.2 | % |
| Operating data: | | | | | | | | |
| Comparable store sales growth for the period (1) | (0.8) | % | (0.2) | % | 1.5 | % | 0.2 | % |
| Number of stores open at end of period | 92 | | 90 | | 92 | | 90 | |
| Non GAAP measures (2): | | | | | | | | |
| Adjusted EBITDA (3) | \$ 21,816 | | \$ 25,561 | | \$ 58,554 | | \$ 58,507 | |
| Adjusted net income (4) | \$ 3,543 | | \$ 5,083 | | \$ 4,279 | | \$ 5,153 | |
| Adjusted net income per common share — diluted (4) | \$ 0.07 | | \$ 0.11 | | \$ 0.09 | | \$ 0.11 | |

(1) A store is included in the comparable store sales calculation on the first day of the sixteenth full fiscal month following the store's opening. Comparable store sales reflect the point at which merchandise and service orders are fulfilled and delivered to customers, excluding shipping and delivery, and are net of discounts and returns. When a store is relocated, we continue to consider net sales from that store to be comparable store sales. Website, call center and business-to-business net sales are also included in calculations of comparable store sales.

(2) We have presented EBITDA, Adjusted EBITDA, adjusted net income, and adjusted net income per diluted share as supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. These non-GAAP measures should not be considered as alternatives to net income as a measure of financial performance or cash flows from operations as a measure of liquidity, or any other performance measure derived in accordance with GAAP and they should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items. These non-GAAP measures are key metrics used by management, our board of directors, and LGP to assess our financial performance. We present these non-GAAP measures

because we believe they assist investors in comparing our performance across reporting periods on a consistent basis by excluding items that we do not believe are indicative of our core operating performance and because we believe it is useful for investors to see the measures that management uses to evaluate the Company. These non-GAAP measures are also frequently used by analysts, investors and other interested parties to evaluate companies in our industry. In evaluating these non-GAAP measures, you should be aware that in the future we will incur expenses that are the same as or similar to some of the adjustments in this presentation. Our presentation of these non-GAAP measures should not be construed to imply that our future results will be unaffected by any such adjustments. Management compensates for these limitations by relying on our GAAP results in addition to using non-GAAP measures supplementally. Our non-GAAP measures are not necessarily comparable to other similarly titled captions of other companies due to different methods of calculation. Please refer to footnotes (3) and (4) of this table for further information regarding why we believe each non-GAAP measure provides useful information to investors regarding our financial condition and results of operations, as well as the additional purposes for which management uses each non-GAAP financial measure.

Table of Contents

Additionally, this Management's Discussion and Analysis also refers to Elfa third-party net sales after the conversion of Elfa's net sales from Swedish krona to U.S. dollars using the prior year's conversion rate. The Company believes the disclosure of Elfa third-party net sales without the effects of currency exchange rate fluctuations helps investors understand the Company's underlying performance.

- (3) EBITDA and Adjusted EBITDA have been presented in this Quarterly Report on Form 10-Q as supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. We define EBITDA as net income before interest, taxes, depreciation, and amortization. Adjusted EBITDA is calculated in accordance with our Secured Term Loan Facility and the Revolving Credit Facility and is one of the components for performance evaluation under our executive compensation programs. Adjusted EBITDA reflects further adjustments to EBITDA to eliminate the impact of certain items, including certain non-cash and other items that we do not consider in our evaluation of ongoing operating performance from period to period as discussed further below.

EBITDA and Adjusted EBITDA, are included in this Quarterly Report on Form 10-Q because they are key metrics used by management, our board of directors and LGP to assess our financial performance. In addition, we use Adjusted EBITDA in connection with covenant compliance and executive performance evaluations, and we use Adjusted EBITDA to supplement GAAP measures of performance to evaluate the effectiveness of our business strategies, to make budgeting decisions and to compare our performance against that of other peer companies using similar measures. We believe it is useful for investors to see the measures that management uses to evaluate the Company, its executives and our covenant compliance, as applicable. EBITDA and Adjusted EBITDA are also frequently used by analysts, investors and other interested parties to evaluate companies in our industry.

EBITDA and Adjusted EBITDA are not GAAP measures of our financial performance or liquidity and should not be considered as alternatives to net income as a measure of financial performance or cash flows from operations as a measure of liquidity, or any other performance measure derived in accordance with GAAP and they should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items. Additionally, EBITDA and Adjusted EBITDA are not intended to be measures of free cash flow for management's discretionary use, as they do not reflect certain cash requirements such as tax payments, debt service requirements, capital expenditures, store openings and certain other cash costs that may recur in the future. EBITDA and Adjusted EBITDA contain certain other limitations, including the failure to reflect our cash expenditures, cash requirements for working capital needs and cash costs to replace assets being depreciated and amortized. In evaluating Adjusted EBITDA, you should be aware that in the future we will incur expenses that are the same as or similar to some of the adjustments in this presentation, such as pre-opening costs and stock compensation expense. Our presentation of Adjusted EBITDA should not be construed to imply that our future results will be unaffected by any such adjustments. Management compensates for these limitations by relying on our GAAP results in addition to using EBITDA and Adjusted EBITDA supplementally. Our measures of EBITDA and Adjusted EBITDA margin are not necessarily comparable to other similarly titled captions of other companies due to different methods of calculation.

Table of Contents

A reconciliation of net income to EBITDA and Adjusted EBITDA is set forth below:

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|--|----------------------|-------------------|-------------------------|-------------------|
| | December 29, 2018 | December 30, 2017 | December 29, 2018 | December 30, 2017 |
| Net income | \$ 9,321 | \$ 28,379 | \$ 5,798 | \$ 19,827 |
| Depreciation and amortization | 8,887 | 9,477 | 27,352 | 28,524 |
| Interest expense, net | 6,008 | 7,300 | 21,293 | 17,398 |
| Income tax benefit | (3,926) | (21,780) | (5,989) | (25,848) |
| EBITDA | 20,290 | 23,376 | 48,454 | 39,901 |
| Pre-opening costs (a) | 691 | 1,872 | 1,918 | 4,676 |
| Non-cash rent (b) | 101 | (714) | (1,117) | (1,451) |
| Stock-based compensation (c) | 632 | 585 | 1,987 | 1,589 |
| Loss on extinguishment of debt (d) | — | — | 2,082 | 2,369 |
| Foreign exchange losses (gains) (e) | 22 | (360) | 69 | (306) |
| Optimization Plan implementation charges (f) | — | 422 | 4,864 | 10,742 |
| Elfa manufacturing facility closure (g) | — | 335 | — | 852 |
| Other adjustments (h) | 80 | 45 | 297 | 135 |
| Adjusted EBITDA | \$ 21,816 | \$ 25,561 | \$ 58,554 | \$ 58,507 |

- (a) Non-capital expenditures associated with opening new stores and relocating stores, including rent, marketing expenses, travel and relocation costs, and training costs. We adjust for these costs to facilitate comparisons of our performance from period to period.
- (b) Reflects the extent to which our annual GAAP rent expense has been above or below our cash rent payment due to lease accounting adjustments. The adjustment varies depending on the average age of our lease portfolio (weighted for size), as our GAAP rent expense on younger leases typically exceeds our cash cost, while our GAAP rent expense on older leases is typically less than our cash cost.
- (c) Non-cash charges related to stock-based compensation programs, which vary from period to period depending on volume and vesting timing of awards. We adjust for these charges to facilitate comparisons from period to period.
- (d) Loss recorded as a result of the amendment made to the Senior Secured Term Loan Facility in September 2018 and the amendments made to the Senior Secured Term Loan Facility and the Revolving Credit Facility in August 2017, which we do not consider in our evaluation of our ongoing operations.
- (e) Realized foreign exchange transactional gains/losses our management does not consider in our evaluation of our ongoing operations.
- (f)

Edgar Filing: Container Store Group, Inc. - Form 10-Q

Charges incurred to implement our Optimization Plan, which include certain consulting costs recorded in selling, general and administrative expenses in the first quarter of fiscal 2018 and in fiscal 2017, cash severance payments associated with the elimination of certain full-time positions at the TCS segment recorded in other expenses in fiscal 2017, and cash severance payments associated with organizational realignment at the Elfa segment recorded in other expenses in fiscal 2017, which we do not consider in our evaluation of ongoing performance.

- (g) Charges related to the closure of an Elfa manufacturing facility in Lahti, Finland in fiscal 2017, recorded in other expenses, which we do not consider in our evaluation of our ongoing performance.
 - (h) Other adjustments include amounts our management does not consider in our evaluation of our ongoing operations, including certain severance and other charges.
- (4) Adjusted net income and adjusted net income per diluted share have been presented in this Quarterly Report on Form 10-Q as supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. We define adjusted net income as net income before restructuring charges, impairment charges related

Table of Contents

to intangible assets, losses on extinguishment of debt, certain gains on disposal of assets, certain management transition costs incurred and benefits realized, charges incurred as part of the implementation of our Optimization Plan, charges associated with an Elfa manufacturing facility closure, and the tax impact of these adjustments and other unusual or infrequent tax items. We define adjusted net income per diluted share as adjusted net income divided by the diluted weighted average common shares outstanding. We use adjusted net income and adjusted net income per diluted share to supplement GAAP measures of performance to evaluate the effectiveness of our business strategies, to make budgeting decisions and to compare our performance against that of other peer companies using similar measures. We present adjusted net income and adjusted net income per diluted share because we believe they assist investors in comparing our performance across reporting periods on a consistent basis by excluding items that we do not believe are indicative of our core operating performance and because we believe it is useful for investors to see the measures that management uses to evaluate the Company.

A reconciliation of the GAAP financial measures of net income and net income per diluted share to the non-GAAP financial measures of adjusted net income and adjusted net income per diluted share is set forth below:

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|--|----------------------|----------------------|-------------------------|----------------------|
| | December 29, 2018 | December 30, 2017 | December 29, 2018 | December 30, 2017 |
| Numerator: | | | | |
| Net income | \$ 9,321 | \$ 28,379 | \$ 5,798 | \$ 19,827 |
| Elfa manufacturing facility closure (a) | — | 335 | — | 852 |
| Gain on disposal of real estate (b) | (387) | — | (387) | — |
| Loss on extinguishment of debt (c) | — | — | 2,082 | 2,369 |
| Optimization Plan implementation charges (d) | — | 422 | 4,864 | 10,742 |
| Taxes (e) | (5,391) | (24,053) | (8,078) | (28,637) |
| Adjusted net income | \$ 3,543 | \$ 5,083 | \$ 4,279 | \$ 5,153 |
| Denominator: | | | | |
| Weighted-average common shares outstanding — diluted | 48,381,455 | 48,167,882 | 48,407,337 | 48,128,682 |
| Net income per common share — diluted | \$ 0.19 | \$ 0.59 | \$ 0.12 | \$ 0.41 |
| Adjusted net income per common share — diluted | \$ 0.07 | \$ 0.11 | \$ 0.09 | \$ 0.11 |

(a) Charges related to the closure of an Elfa manufacturing facility in Lahti, Finland in December 2017, recorded in other expenses, which we do not consider in our evaluation of our ongoing performance.

(b) Gain recorded as a result of the sale of a building in Lahti, Finland in fiscal 2018, recorded in (gain) loss on disposal of assets, which we do not consider in our evaluation of our ongoing operations.

(c)

Loss recorded as a result of the amendment made to the Senior Secured Term Loan Facility in September 2018 and the amendments made to the Senior Secured Term Loan Facility and the Revolving Credit Facility in August 2017, which we do not consider in our evaluation of our ongoing operations.

- (d) Charges incurred to implement our Optimization Plan, which include certain consulting costs recorded in selling, general and administrative expenses in the first quarter of fiscal 2018 and in fiscal 2017, cash severance payments associated with the elimination of certain full-time positions at the TCS segment recorded in other expenses in fiscal 2017, and cash severance payments associated with organizational realignment at the Elfa segment recorded in other expenses in fiscal 2017, which we do not consider in our evaluation of ongoing performance.

- (e) Tax impact of adjustments to net income, as well as the estimated impact of the Tax Cuts and Jobs Act recorded in fiscal 2017, the tax benefit recorded in the first quarter of fiscal 2018 as a result of a reduction in the Swedish tax rate, and the tax benefit recorded in the third quarter of fiscal 2018 as a result of the finalization of the impact of the Tax Cuts and Jobs Act, which are considered to be unusual or infrequent tax items, all of which we do not consider in our evaluation of ongoing performance.

Table of Contents

Thirteen Weeks Ended December 29, 2018 Compared to Thirteen Weeks Ended December 30, 2017

Net sales

The following table summarizes our net sales for each of the thirteen weeks ended December 29, 2018 and December 30, 2017:

| | December 29, 2018 | | December 30, 2017 | |
|----------------------------|----------------------|---------|----------------------|---------|
| | | % total | | % total |
| TCS net sales | \$ 204,899 | 92.4 % | \$ 203,881 | 91.4 % |
| Elfa third party net sales | 16,738 | 7.6 % | 19,105 | 8.6 % |
| Net sales | \$ 221,637 | 100.0 % | \$ 222,986 | 100.0 % |

Net sales in the thirteen weeks ended December 29, 2018 decreased by \$1,349, or 0.6%, compared to the thirteen weeks ended December 30, 2017. This decrease is comprised of the following components:

| | Net sales |
|---|------------|
| Net sales for the thirteen weeks ended December 30, 2017 | \$ 222,986 |
| Incremental net sales increase (decrease) due to: | |
| Comparable stores (including a \$1,711 or 9.9% increase in online sales) | (1,685) |
| New stores | 2,604 |
| Elfa third party net sales (excluding impact of foreign currency translation) | (949) |
| Impact of foreign currency translation on Elfa third party net sales | (1,417) |
| Shipping and delivery | 98 |
| Net sales for the thirteen weeks ended December 29, 2018 | \$ 221,637 |

In the thirteen weeks ended December 29, 2018, comparable stores generated a decrease of \$1,685, or 0.8%, in net sales. Additionally, five new stores generated \$2,604 of incremental net sales, three of which were opened during fiscal 2017 and two of which were opened in the first thirty-nine weeks of fiscal 2018. Elfa third party net sales decreased \$2,366 in the thirteen weeks ended December 29, 2018. After converting Elfa's third party net sales from Swedish krona to U.S. dollars using the prior year's conversion rate for both the thirteen weeks ended December 29, 2018 and thirteen weeks ended December 30, 2017, Elfa third party net sales decreased \$949 primarily due to lower net sales in Nordic and Russian markets.

Gross profit and gross margin

Gross profit in the thirteen weeks ended December 29, 2018 decreased by \$504, or 0.4%, compared to the thirteen weeks ended December 30, 2017. The decrease in gross profit was primarily the result of decreased consolidated net sales, partially offset by an increase in consolidated gross margin. The following table summarizes the gross margin for the thirteen weeks ended December 29, 2018 and December 30, 2017 by segment and total. The segment gross margins include the impact of inter-segment net sales from the Elfa segment to the TCS segment:

| | December 29, 2018 | | December 30, 2017 | |
|--------------------|-------------------|---|-------------------|---|
| TCS gross margin | 58.4 | % | 58.1 | % |
| Elfa gross margin | 32.4 | % | 36.3 | % |
| Total gross margin | 58.7 | % | 58.6 | % |

TCS gross margin increased 30 basis points primarily due to lower cost of goods associated with the Optimization Plan, partially offset by higher promotional activities and a negative impact from foreign currency. Elfa gross margin declined 390 basis points primarily due to higher direct materials costs attributable to a shift in product mix and a weaker Swedish krona during the quarter. In total, gross margin increased 10 basis points primarily due to the increase in TCS gross margin during the quarter.

Table of Contents

Selling, general and administrative expenses

Selling, general and administrative expenses (“SG&A”) in the thirteen weeks ended December 29, 2018 increased by \$4,794, or 4.6%, compared to the thirteen weeks ended December 30, 2017. As a percentage of consolidated net sales, SG&A increased by 240 basis points. The following table summarizes SG&A as a percentage of total net sales for the thirteen weeks ended December 29, 2018 and December 30, 2017:

| | December 29, 2018 | | December 30, 2017 | |
|---|-------------------|---|-------------------|---|
| | % of Net sales | | % of Net sales | |
| TCS selling, general and administrative | 45.4 | % | 42.7 | % |
| Elfa selling, general and administrative | 3.6 | % | 3.9 | % |
| Total selling, general and administrative | 49.0 | % | 46.6 | % |

TCS selling, general and administrative expenses increased by 270 basis points as a percentage of consolidated net sales. This was primarily due to the deleverage of occupancy and payroll costs associated with negative comparable store sales, as well as increased marketing expense in the third quarter of fiscal 2018 associated with a shift in the timing of recognition of campaign-related marketing costs from the fourth fiscal quarter to the third fiscal quarter due to accounting changes. Elfa selling, general and administrative expenses decreased by 30 basis points as a percentage of consolidated net sales, primarily due to a higher percentage of consolidated net sales attributable to the TCS segment in the thirteen weeks ended December 29, 2018 as compared to the thirteen weeks ended December 30, 2017.

Pre-opening costs

Pre-opening costs decreased by \$1,181, or 63.1%, in the thirteen weeks ended December 29, 2018 to \$691, as compared to \$1,872 in the thirteen weeks ended December 30, 2017. We opened two relocation stores in the thirteen weeks ended December 29, 2018, and we opened three stores, including one relocation store, in the thirteen weeks ended December 30, 2017.

Other expenses

Other expenses of \$80 were recorded in the thirteen weeks ended December 29, 2018, as compared to \$751 in the thirteen weeks ended December 30, 2017. The \$671 decrease in other expenses is primarily due to expenses incurred in the thirteen weeks ended December 30, 2017 in connection with the Optimization Plan, as well as the closure of the Elfa manufacturing facility in Lahti, Finland in December 2017.

Interest expense

Interest expense decreased by \$1,292, or 17.7%, in the thirteen weeks ended December 29, 2018 to \$6,008, as compared to \$7,300 in the thirteen weeks ended December 30, 2017. On September 14, 2018, we entered into a fifth amendment (the “Fifth Amendment”) to the Credit Agreement dated as of April 6, 2012 (“Senior Secured Term Loan Facility”). The Fifth Amendment amended the Senior Secured Term Loan Facility to, among other things, decrease the applicable interest rate margin to 5.00% for LIBOR loans and 4.00% for base rate loans, which resulted in lower interest expense during the thirteen weeks ended December 29, 2018. As a result of entering the Fifth Amendment, we expect to incur approximately \$28,000 of total interest expense in fiscal 2018.

Taxes

The benefit for income taxes in the thirteen weeks ended December 29, 2018 was \$3,926 as compared to the benefit for income taxes of \$21,780 in the thirteen weeks ended December 30, 2017. The effective tax rate for the thirteen weeks ended December 29, 2018 was -72.8%, as compared to -330.1% in the thirteen weeks ended December 30, 2017. During the thirteen weeks ended December 29, 2018, the effective tax rate fell below the U.S statutory rate primarily due to the finalization of the one-time transition tax on foreign earnings related to the Tax Cuts and Jobs Act (the “Tax Act”) enacted in fiscal 2017. During the thirteen weeks ended December 30, 2017, the effective tax rate fell below the blended

Table of Contents

U.S. statutory rate of 31.5% primarily due to the estimated impact of the Tax Act, which was primarily driven by the remeasurement of deferred tax balances.

Thirty-Nine Weeks Ended December 29, 2018 Compared to Thirty-Nine Weeks Ended December 30, 2017

Net sales

The following table summarizes our net sales for each of the thirty-nine weeks ended December 29, 2018 and December 30, 2017:

| | December 29, 2018 | | December 30, 2017 | |
|----------------------------|----------------------|---------|----------------------|---------|
| | | % total | | % total |
| TCS net sales | \$ 593,896 | 92.5 % | \$ 573,261 | 91.8 % |
| Elfa third party net sales | 48,017 | 7.5 % | 51,203 | 8.2 % |
| Net sales | \$ 641,913 | 100.0 % | \$ 624,464 | 100.0 % |

Net sales in the thirty-nine weeks ended December 29, 2018 increased by \$17,449, or 2.8%, compared to the thirty-nine weeks ended December 30, 2017. This increase is comprised of the following components:

| | Net sales |
|---|------------|
| Net sales for the thirty-nine weeks ended December 30, 2017 | \$ 624,464 |
| Incremental net sales increase (decrease) due to: | |
| Comparable stores (including a \$8,421, or 17.5%, increase in online sales) | 8,683 |
| New stores | 11,733 |
| Elfa third party net sales (excluding impact of foreign currency translation) | (526) |
| Impact of foreign currency translation on Elfa third party net sales | (2,660) |
| Shipping and delivery | 219 |
| Net sales for the thirty-nine weeks ended December 29, 2018 | \$ 641,913 |

In the thirty-nine weeks ended December 29, 2018, comparable stores generated an increase of \$8,683, or 1.5%, in net sales. Additionally, six new stores generated \$11,733 of incremental net sales, four of which were opened during fiscal 2017 and two of which were opened in the first thirty-nine weeks of fiscal 2018. Elfa third party net sales decreased \$3,186 in the thirty-nine weeks ended December 29, 2018. After converting Elfa's third party net sales from Swedish krona to U.S. dollars using the prior year's conversion rate for both the thirty-nine weeks ended December 29, 2018 and thirty-nine weeks ended December 30, 2017, Elfa third party net sales decreased \$526 primarily due to lower net sales in Russian markets.

Gross profit and gross margin

Gross profit in the thirty-nine weeks ended December 29, 2018 increased by \$14,858, or 4.1%, compared to the thirty-nine weeks ended December 30, 2017. The increase in gross profit was primarily the result of increased consolidated net sales, combined with an increase in consolidated gross margin. The following table summarizes the gross margin for the thirty-nine weeks ended December 29, 2018 and December 30, 2017 by segment and total. The segment gross margins include the impact of inter-segment net sales from the Elfa segment to the TCS segment:

| | December 29, 2018 | | December 30, 2017 | |
|--------------------|-------------------|---|-------------------|---|
| TCS gross margin | 58.0 | % | 57.3 | % |
| Elfa gross margin | 34.5 | % | 37.6 | % |
| Total gross margin | 58.5 | % | 57.7 | % |

TCS gross margin increased 70 basis points primarily due to lower cost of goods associated with the Optimization Plan, partially offset by higher promotional activities and increased costs associated with shipping services. Elfa gross margin declined 310 basis points primarily due to higher direct materials costs attributable to a shift in product mix and a weaker Swedish krona during the first thirty-nine weeks of fiscal 2018. In total, gross margin increased 80 basis points primarily due to the increase in TCS gross margin during the first thirty-nine weeks of fiscal 2018.

Table of Contents

Selling, general and administrative expenses

SG&A in the thirty-nine weeks ended December 29, 2018 increased by \$14,083, or 4.6%, compared to the thirty-nine weeks ended December 30, 2017. As a percentage of consolidated net sales, SG&A increased by 90 basis points. The following table summarizes SG&A as a percentage of total net sales for the thirty-nine weeks ended December 29, 2018 and December 30, 2017:

| | December 29, 2018 | | December 30, 2017 | |
|---|-------------------|---|-------------------|---|
| | % of Net sales | | % of Net sales | |
| TCS selling, general and administrative | 46.4 | % | 45.1 | % |
| Elfa selling, general and administrative | 3.6 | % | 4.0 | % |
| Total selling, general and administrative | 50.0 | % | 49.1 | % |

TCS selling, general and administrative expenses increased by 130 basis points as a percentage of consolidated net sales. The increase was primarily attributable to deleverage of occupancy costs, higher payroll costs, and increased marketing expense associated with the branding campaign launch in the second quarter of fiscal of 2018. Elfa selling, general and administrative expenses decreased by 40 basis points as a percentage of consolidated net sales, primarily due to ongoing savings and efficiency efforts.

Pre-opening costs

Pre-opening costs decreased by \$2,758, or 59.0%, in the thirty-nine weeks ended December 29, 2018 to \$1,918, as compared to \$4,676 in the thirty-nine weeks ended December 30, 2017. We opened four stores, including two relocations, in the thirty-nine weeks ended December 29, 2018, and we opened five stores, including one relocation, in the thirty-nine weeks ended December 30, 2017.

Other expenses

Other expenses of \$297 were recorded in the thirty-nine weeks ended December 29, 2018, as compared to \$4,908 in the thirty-nine weeks ended December 30, 2017. The decrease is primarily due to severance costs incurred in the first thirty-nine weeks of fiscal 2017 to implement the Optimization Plan and related to the closure of an Elfa manufacturing facility in Lahti, Finland.

Interest expense and loss on extinguishment of debt

Interest expense increased by \$3,895, or 22.4%, in the thirty-nine weeks ended December 29, 2018 to \$21,293, as compared to \$17,398 in the thirty-nine weeks ended December 30, 2017. The increase is primarily due to the amendment of our Senior Secured Term Loan Facility in the second quarter of fiscal 2017, which increased the applicable interest rate margins prior to the subsequent amendment of our Senior Secured Term Loan Facility in September 2018.

Additionally, we recorded a loss on extinguishment of debt of \$2,082 and \$2,369 in the thirty-nine weeks ended December 29, 2018 and December 30, 2017, respectively, as a result of amendments to the Senior Secured Term Loan Facility in each fiscal period.

Taxes

The benefit for income taxes in the thirty-nine weeks ended December 29, 2018 was \$5,989 as compared to a benefit of \$25,848, in the thirty-nine weeks ended December 30, 2017. The effective tax rate for the thirty-nine weeks ended December 29, 2018 was 3135.6%, as compared to 429.3% in the thirty-nine weeks ended December 30, 2017. During the thirty-nine weeks ended December 29, 2018, the effective tax rate rose above the U.S. statutory rate due to the finalization of the one-time transition tax on foreign earnings and other Tax Act items, and recognition of a \$604 tax benefit for the remeasurement of deferred tax balances as a result of a change in the Swedish tax rate, combined with a year-to-date pre-tax loss. During the thirty-nine weeks ended December 30, 2017, the effective tax rate rose above the

Table of Contents

blended U.S. statutory rate of 31.5% primarily due to the estimated impact of the Tax Act, which was primarily driven by the remeasurement of deferred tax balances.

Liquidity and Capital Resources

We rely on cash flows from operations, our \$100,000 asset-based revolving credit agreement (the “Revolving Credit Facility” as further discussed under “Revolving Credit Facility” below), and the SEK 140.0 million (approximately \$15.8 million as of December 29, 2018) 2014 Elfa revolving credit facility (the “2014 Elfa Revolving Credit Facility” as further discussed under “2014 Elfa Senior Secured Credit Facilities” below) as our primary sources of liquidity. Our primary cash needs are for merchandise inventories, direct materials, payroll, store rent, capital expenditures associated with opening new stores and updating existing stores, as well as information technology and infrastructure, including our existing and future distribution centers, and Elfa manufacturing facility enhancements. The most significant components of our operating assets and liabilities are merchandise inventories, accounts receivable, prepaid expenses and other assets, accounts payable, other current and non-current liabilities, taxes receivable and taxes payable. Our liquidity fluctuates as a result of our building inventory for key selling periods, and as a result, our borrowings are generally higher during these periods when compared to the rest of our fiscal year. Our borrowings generally increase in our second and third fiscal quarters as we prepare for Our Annual Shelving Sale, the holiday season, and Our Annual elfa® Sale. We believe that cash expected to be generated from operations and the availability of borrowings under the Revolving Credit Facility and the 2014 Elfa Revolving Credit Facility will be sufficient to meet liquidity requirements, anticipated capital expenditures, and payments due under our existing credit facilities for at least the next 12 months. In the future, we may seek to raise additional capital, which could be in the form of loans, bonds, convertible debt or equity, to fund our operations and capital expenditures. There can be no assurance that we will be able to raise additional capital on favorable terms.

At December 29, 2018, we had \$20,969 of cash, of which \$8,661 was held by our foreign subsidiaries. In addition, we had \$53,295 of additional availability under the Revolving Credit Facility and approximately \$15,792 of additional availability under the 2014 Elfa Revolving Credit Facility as of December 29, 2018. There were \$3,826 in letters of credit outstanding under the Revolving Credit Facility and other contracts at that date.

Pursuant to the Tax Act, we are required to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred. As of December 29, 2018, we have \$1,819 recorded as a liability on our consolidated balance sheet for the one-time transition tax, which is required to be paid in installments over the next 7 years. Future amounts earned in our foreign subsidiaries are not expected to be subject to federal income taxes upon transfer to the United States. However, if these funds were transferred to the United States, we may be required to pay taxes in certain international jurisdictions as well as certain states. It is our intent to indefinitely reinvest these funds outside the United States.

Table of Contents

Cash flow analysis

A summary of our operating, investing and financing activities are shown in the following table:

| | Thirty-Nine Weeks Ended | |
|---|-------------------------|----------------------|
| | December 29, 2018 | December 30, 2017 |
| Net cash provided by operating activities | \$ 17,823 | \$ 39,392 |
| Net cash used in investing activities | (20,413) | (20,082) |
| Net cash provided by (used in) financing activities | 15,737 | (8,170) |
| Effect of exchange rate changes on cash | (577) | 777 |
| Net increase in cash | \$ 12,570 | \$ 11,917 |
| Free cash flow (Non-GAAP)(1) | \$ (3,505) | \$ 19,291 |

(1) See below for a discussion of this non-GAAP financial measure and reconciliation to its most directly comparable GAAP financial measure.

Net cash provided by operating activities

Cash from operating activities consists primarily of net income adjusted for non-cash items, including depreciation and amortization, deferred taxes and the effect of changes in operating assets and liabilities.

Net cash provided by operating activities was \$17,823 for the thirty-nine weeks ended December 29, 2018. Non-cash items of \$29,029 and net income of \$5,798 were partially offset by a net change in operating assets and liabilities of \$17,004. The net change in operating assets and liabilities is primarily due to an increase in merchandise inventory, partially offset by an increase in accounts payable and accrued liabilities during the thirty-nine weeks ended December 29, 2018.

Net cash provided by operating activities was \$39,392 for the thirty-nine weeks ended December 30, 2017. Net income of \$19,827 and non-cash items of \$7,694 were combined with a net change in operating assets and liabilities of \$11,871. The net change in operating assets and liabilities is primarily due to an increase in accounts payable and accrued liabilities, partially offset by an increase in merchandise inventory and decreases in income taxes payable and other noncurrent liabilities, during the thirty-nine weeks ended December 30, 2017.

Net cash used in investing activities

Investing activities consist primarily of capital expenditures for new store openings, existing store remodels, infrastructure, information systems, and our distribution centers.

Our total capital expenditures for the thirty-nine weeks ended December 29, 2018 were \$21,328 with new store openings, relocations and existing store remodels accounting for less than half of spending at \$8,703. We opened four stores, including two relocations, during the thirty-nine weeks ended December 29, 2018. We incurred \$5,674 of capital expenditures for distribution centers, the majority of which is related to the new distribution center in Aberdeen, Maryland, which is expected to be operating in late fiscal 2019. The remaining capital expenditures of \$6,951 were primarily for investments in information technology and new product rollouts. We recorded proceeds from the sale of property, plant and equipment of \$915, the majority of which is related to a sale of a building in Lahti, Finland in the third quarter of fiscal 2018.

Our total capital expenditures for the thirty-nine weeks ended December 30, 2017 were \$20,101 with new store openings, relocations and existing store remodels accounting for more than half of spending at \$11,466. We opened five stores, including one relocation, during the thirty-nine weeks ended December 30, 2017. The remaining capital expenditures of \$8,635 were primarily for investments in information technology, our corporate offices and distribution center enhancements.

Table of Contents

Net cash provided by (used in) financing activities

Financing activities consist primarily of borrowings and payments under the Senior Secured Term Loan Facility, the Revolving Credit Facility, and the Elfa Revolving Credit Facility.

Net cash provided by financing activities was \$15,737 for the thirty-nine weeks ended December 29, 2018. This included net proceeds of \$42,000 from borrowings under the Revolving Credit Facility, partially offset by net payments of \$23,751 for repayment of long-term indebtedness, debt issuance costs of \$2,384, and \$128 for taxes paid with the withholding of shares upon vesting of restricted stock awards.

Net cash used in financing activities was \$8,170 for the thirty-nine weeks ended December 30, 2017. This included \$11,246 for payment of debt issuance costs, net payments of \$21,885 for repayment of long-term indebtedness, and \$39 for taxes paid with the withholding of shares upon vesting of restricted stock awards partially offset by net proceeds of \$25,000 from borrowings under the Revolving Credit Facility.

As of December 29, 2018, TCS had a total of \$53,295 of unused borrowing availability under the Revolving Credit Facility, and \$42,000 of borrowings outstanding under the Revolving Credit Facility.

As of December 29, 2018, Elfa had a total of \$15,792 of unused borrowing availability under the 2014 Elfa Revolving Credit Facility and zero borrowings outstanding under the 2014 Elfa Revolving Credit Facility.

Free cash flow (Non-GAAP)

We present free cash flow, which we define as net cash provided by operating activities in a period minus payments for property and equipment made in that period, because we believe it is a useful indicator of the Company's overall liquidity, as the amount of free cash flow generated in any period is representative of cash that is available for debt repayment, investment, and other discretionary and non-discretionary cash uses. Accordingly, we believe that free cash flow provides useful information to investors in understanding and evaluating our liquidity in the same manner as management. Our definition of free cash flow is limited in that it does not solely represent residual cash flows available for discretionary expenditures due to the fact that the measure does not deduct the payments required for debt service and other contractual obligations. Therefore, we believe it is important to view free cash flow as a measure that provides supplemental information to our Consolidated Statements of Cash Flows. Although other companies report their free cash flow, numerous methods may exist for calculating a company's free cash flow. As a result, the method used by our management to calculate our free cash flow may differ from the methods used by other companies to calculate their free cash flow.

Our free cash flow fluctuates as a result of seasonality of net sales, building inventory for key selling periods, and timing of investments in new store openings, existing store remodels, infrastructure, information systems, and our distribution center, among other things. Historically, our free cash flow has been lower in the first half of the fiscal

Edgar Filing: Container Store Group, Inc. - Form 10-Q

year, due to lower net sales, operating income, and cash flows from operations, and as such, is not necessarily indicative of the free cash flow for the full year.

The following table sets forth a reconciliation of free cash flow, a non-GAAP financial measure, to net cash provided by operating activities, which we believe to be the GAAP financial measure most directly comparable to free cash flow:

| | Thirty-Nine Weeks Ended | |
|---|-------------------------|----------------------|
| | December 29, 2018 | December 30, 2017 |
| Net cash provided by operating activities | \$ 17,823 | \$ 39,392 |
| Less: Additions to property and equipment | (21,328) | (20,101) |
| Free cash flow | \$ (3,505) | \$ 19,291 |

Table of Contents

Senior Secured Term Loan Facility

On April 6, 2012, The Container Store Group, Inc., The Container Store, Inc. and certain of our domestic subsidiaries entered into the Senior Secured Term Loan Facility. On September 14, 2018 (the “Effective Date”), the Company entered into a Fifth Amendment to the Senior Secured Term Loan Facility. The Fifth Amendment amended the Senior Secured Term Loan Facility to, among other things, (i) extend the maturity date of the loans under the Senior Secured Term Loan Facility to September 14, 2023, (ii) decrease the applicable interest rate margin to 5.00% for LIBOR loans and 4.00% for base rate loans and, beginning from the date that a compliance certificate is delivered to the administrative agent for the fiscal year ending March 30, 2019, allow the applicable interest rate margin to step down to 4.75% for LIBOR loans and 3.75% for base rate loans upon achievement of a consolidated leverage ratio equal to or less than 2.75:1.00, and (iii) impose a 1.00% premium if a voluntary prepayment is made from the proceeds of a repricing transaction within 12 months after the Effective Date.

In connection with the Fifth Amendment, we repaid \$20,000 of the outstanding loans under the Senior Secured Term Loan Facility, which reduced the aggregate principal amount of the Senior Secured Term Loan Facility to \$272,500. We drew down a net amount of approximately \$10,000 on our revolving credit facility in connection with the closing of the Fifth Amendment. As of December 29, 2018, the aggregate principal amount of the Senior Secured Term Loan Facility was \$270,797.

The Senior Secured Term Loan Facility is secured by (a) a first priority security interest in substantially all of our assets (excluding stock in foreign subsidiaries in excess of 65%, assets of non-guarantors and certain other exceptions) (other than the collateral that secures the Revolving Credit Facility described below on a first-priority basis) and (b) a second priority security interest in the assets securing the Revolving Credit Facility described below on a first-priority basis. Obligations under the Senior Secured Term Loan Facility are guaranteed by The Container Store Group, Inc. and each of The Container Store, Inc.’s U.S. subsidiaries. The Senior Secured Term Loan Facility contains a number of covenants that, among other things, restrict our ability, subject to specified exceptions, to incur additional debt; incur additional liens and contingent liabilities; sell or dispose of assets; merge with or acquire other companies; liquidate or dissolve ourselves, engage in businesses that are not in a related line of business; make loans, advances or guarantees; engage in transactions with affiliates; and make investments. In addition, the financing agreements contain certain cross-default provisions and also require certain mandatory prepayments of the Senior Secured Term Loan Facility, among these an Excess Cash Flow requirement (as such term is defined in the Senior Secured Term Loan Facility). As of December 29, 2018, we were in compliance with all covenants and no Event of Default (as such term is defined in the Senior Secured Term Loan Facility) had occurred.

Revolving Credit Facility

On April 6, 2012, The Container Store Group, Inc., The Container Store, Inc. and certain of our domestic subsidiaries entered into an asset-based revolving credit agreement with the lenders party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, and Wells Fargo Bank, National Association, as Syndication Agent (as amended, the “Revolving Credit Facility”). The maturity date of the loans under the Revolving Credit Facility is the earlier of (i) August 18, 2022 and (ii) May 18, 2021 if any portion of the Senior Secured Term Loan Facility remains outstanding on such date and the maturity date of the Senior Secured Term Loan Facility is not extended.

The aggregate principal amount of the facility is \$100,000. Borrowings under the Revolving Credit Facility accrue interest at LIBOR+1.25%. In addition, the Revolving Credit Facility includes an uncommitted incremental revolving facility in the amount of \$50,000, which is subject to receipt of lender commitments and satisfaction of specified conditions.

The Revolving Credit Facility provides that proceeds are to be used for working capital and other general corporate purposes, and allows for swing line advances of up to \$15,000 and the issuance of letters of credit of up to \$40,000.

The availability of credit at any given time under the Revolving Credit Facility is limited by reference to a borrowing base formula based upon numerous factors, including the value of eligible inventory, eligible accounts receivable, and reserves established by the administrative agent. As a result of the borrowing base formula, the actual borrowing

Table of Contents

availability under the Revolving Credit Facility could be less than the stated amount of the Revolving Credit Facility (as reduced by the actual borrowings and outstanding letters of credit under the Revolving Credit Facility).

The Revolving Credit Facility is secured by (a) a first-priority security interest in substantially all of our personal property, consisting of inventory, accounts receivable, cash, deposit accounts, and other general intangibles, and (b) a second-priority security interest in the collateral that secures the Senior Secured Term Loan Facility on a first-priority basis, as described above (excluding stock in foreign subsidiaries in excess of 65%, and assets of non-guarantor subsidiaries and subject to certain other exceptions). Obligations under the Revolving Credit Facility are guaranteed by The Container Store Group, Inc. and each of The Container Store, Inc.'s U.S. subsidiaries.

The Revolving Credit Facility contains a number of covenants that, among other things, restrict our ability, subject to specified exceptions, to incur additional debt; incur additional liens and contingent liabilities; sell or dispose of assets; merge with or acquire other companies; liquidate or dissolve ourselves, engage in businesses that are not in a related line of business; make loans, advances or guarantees; engage in transactions with affiliates; and make investments. In addition, the financing agreements contain certain cross-default provisions. We are required to maintain a consolidated fixed-charge coverage ratio of 1.0 to 1.0 if excess availability is less than \$10,000 at any time. As of December 29, 2018, we were in compliance with all covenants and no Event of Default (as such term is defined in the Revolving Credit Facility) had occurred.

2014 Elfa Senior Secured Credit Facilities

On April 1, 2014, Elfa entered into a master credit agreement with Nordea Bank AB ("Nordea"), which consists of a SEK 60.0 million (approximately \$6,768 as of December 29, 2018) term loan facility (the "2014 Elfa Term Loan Facility") and a SEK 140.0 million (approximately \$15,792 as of December 29, 2018) revolving credit facility (the "2014 Elfa Revolving Credit Facility," and together with the 2014 Elfa Term Loan Facility, the "2014 Elfa Senior Secured Credit Facilities"). The 2014 Elfa Senior Secured Credit Facilities term began on August 29, 2014 and matures on August 29, 2019, or such shorter period as provided by the agreement. The remaining balance of the 2014 Elfa Term Loan Facility was paid on February 18, 2018, which was prior to the maturity date. Elfa was required to make quarterly principal payments under the 2014 Elfa Term Loan Facility in the amount of SEK 3.0 million (approximately \$338 as of December 29, 2018). The 2014 Elfa Revolving Credit Facility bears interest at Nordea's base rate + 1.4%. In the fourth quarter of fiscal 2016, Elfa and Nordea agreed that the stated rates would apply through maturity.

The 2014 Elfa Senior Secured Credit Facilities contain a number of covenants that, among other things, restrict Elfa's ability, subject to specified exceptions, to incur additional liens, sell or dispose of assets, merge with other companies, engage in businesses that are not in a related line of business and make guarantees. In addition, Elfa is required to maintain (i) a consolidated equity ratio (as defined in the 2014 Elfa Senior Secured Credit Facilities) of not less than 30% in year one and not less than 32.5% thereafter and (ii) a consolidated ratio of net debt to EBITDA (as defined in the 2014 Elfa Senior Secured Credit Facilities) of less than 3.2, the consolidated equity ratio tested at the end of each

calendar quarter and the ratio of net debt to EBITDA tested as of the end of each fiscal quarter. As of December 29, 2018, Elfa was in compliance with all covenants and no Event of Default (as defined in the 2014 Elfa Senior Secured Credit Facilities) had occurred.

Critical accounting policies and estimates

The preparation of financial statements in accordance with generally accepted accounting principles in the United States requires management to make estimates and assumptions about future events that affect amounts reported in our consolidated financial statements and related notes, as well as the related disclosure of contingent assets and liabilities at the date of the financial statements. A summary of our significant accounting policies is included in Note 1 to our annual consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the SEC on May 31, 2018.

Certain of our accounting policies and estimates are considered critical, as these policies and estimates are the most important to the depiction of our consolidated financial statements and require significant, difficult, or complex judgments, often about the effect of matters that are inherently uncertain. Such policies are summarized in the

Table of Contents

“Management’s Discussion and Analysis of Financial Condition and Results of Operations” section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the SEC on May 31, 2018. As of December 29, 2018, there were no significant changes to any of our critical accounting policies and estimates, with the exception of the adoption of ASU 2014-09, Revenue from Contracts with Customers, as discussed in Note 1 of our unaudited consolidated financial statements.

Contractual obligations

There have been no material changes to our contractual obligations as disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the SEC on May 31, 2018, other than those shown in the table below, as a result of the Fifth Amendment to our Senior Secured Term Loan Facility executed in the second quarter of fiscal 2018, as well as the finalization of the one-time transition tax on foreign earnings in the third quarter of fiscal 2018. The table below has been updated to reflect our contractual obligations as of December 29, 2018 related to the Fifth Amendment and the one-time transition tax on foreign earnings.

| | Payments due by period | | | | |
|------------------------------------|------------------------|------------------|-----------|------------|---------------|
| | Total | Within 1 Year | 1 3 Years | 3 5 Years | After 5 Years |
| Recorded contractual obligations | | | | | |
| Term loans | \$ 270,797 | \$ 6,813 | \$ 13,626 | \$ 250,358 | \$ — |
| Revolving loans | 42,000 | — | 42,000 | — | — |
| Other long-term obligations (1) | 1,819 | 199 | 398 | 573 | 649 |
| Unrecorded contractual obligations | | | | | |
| Estimated interest (2) | 93,215 | 21,282 | 40,184 | 31,749 | — |
| Total | \$ 407,831 | \$ 28,294 | \$ 96,208 | \$ 282,680 | \$ 649 |

(1) One-time transition tax on foreign earnings that will be paid over 7 years.

(2) For purposes of this table, interest has been estimated based on interest rates in effect for our indebtedness as of December 29, 2018, and estimated borrowing levels in the future. Actual borrowing levels and interest costs may differ.

Off Balance Sheet Arrangements

We are not party to any off balance sheet arrangements.

Recent Accounting Pronouncements

Please refer to Note 1 of our unaudited consolidated financial statements for a summary of recent accounting pronouncements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risk profile as of December 29, 2018 has not materially changed since March 31, 2018. Our market risk profile as of March 31, 2018 is disclosed in our Annual Report on Form 10-K filed with the SEC on May 31, 2018. See Note 8 of Notes to our unaudited consolidated financial statements included in Part I, Item 1, of this Form 10-Q, for disclosures on our foreign currency forward contracts.

ITEM 4. CONTROLS AND PROCEDURES

Limitations on Effectiveness of Controls and Procedures

In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are

Table of Contents

resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated, as of the end of the period covered by this Quarterly Report on Form 10-Q, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of December 29, 2018.

Changes in Internal Control

There were no changes in our internal control over financial reporting identified in management’s evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the quarter ended December 29, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes to our risk factors as previously disclosed in Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the SEC on May 31, 2018.

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

None.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

38

Table of Contents

ITEM 6. EXHIBITS

| Exhibit Number | Exhibit Description | Incorporated by Reference | | | Filing Date | Filed/ Furnished Herewith |
|----------------|---|---------------------------|-----------|---------|-------------|---------------------------------|
| | | Form | File No. | Exhibit | | |
| 3.1 | <u>Amended and Restated Certificate of Incorporation of The Container Store Group, Inc.</u> | 10-Q | 001-36161 | 3.1 | 1/10/14 | |
| 3.2 | <u>Amended and Restated By-laws of The Container Store Group, Inc.</u> | 10-Q | 001-36161 | 3.2 | 1/10/14 | |
| 10.1 | <u>Fourth Amended and Restated Employment Agreement, dated January 23, 2019, between Melissa Reiff and The Container Store Group, Inc.</u> | 8-K | 001-36161 | 10.1 | 1/24/19 | |
| 10.2 | <u>Fourth Amended and Restated Employment Agreement, dated January 23, 2019, between Sharon Tindell and The Container Store Group, Inc.</u> | 8-K | 001-36161 | 10.2 | 1/24/19 | |
| 10.3 | <u>Amended and Restated Employment Agreement, dated January 23, 2019 between Jodi Taylor and The Container Store Group, Inc.</u> | 8-K | 001-36161 | 10.3 | 1/24/19 | |
| 31.1 | <u>Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)</u> | | | | | * |
| 31.2 | <u>Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)</u> | | | | | * |
| 32.1 | <u>Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350</u> | | | | | ** |
| 32.2 | <u>Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350</u> | | | | | ** |
| 101.INS | XBRL Instance Document | | | | | * |
| 101.SCH | XBRL Taxonomy Extension Schema Document | | | | | * |
| 101.CAL | XBRL Taxonomy Calculation Linkbase Document | | | | | * |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | | | | | * |

Table of Contents

| | | |
|---------|---|---|
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | * |
| 101.PRE | XBRL Taxonomy Extension Presentation | * |

* Filed herewith.

** Furnished herewith.

40

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

The Container Store Group, Inc.

(Registrant)

Date: February 6, 2019 \s\ Jodi L. Taylor
Jodi L. Taylor
Chief Financial Officer and Chief
Administrative Officer (duly authorized
officer and Principal Financial Officer)

Date: February 6, 2019 \s\ Jeffrey A. Miller
Jeffrey A. Miller
Chief Accounting Officer (Principal
Accounting Officer)