Container Store Group, Inc.
Form 10-Q
October 10, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the Quarterly Period Ended August 30, 2014

OR

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

For the transition period from to

Commission File Number: 001-36161

THE CONTAINER STORE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**26-0565401**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
500 Freeport Parkway Coppell, TX	**75019**
(Addresses of principal executive offices)	(Zip Codes)

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

None

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

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

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

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

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

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

The registrant had 47,979,297 shares of its common stock outstanding as of September 26, 2014.

TABLE OF CONTENTS

PART I.	**FINANCIAL INFORMATION**	
Item 1.	Financial Statements	
	Unaudited Consolidated Balance Sheets as of August 30, 2014, March 1, 2014, and August 31, 2013	3
	Unaudited Consolidated Statements of Operations for the Thirteen and Twenty-Six Weeks Ended August 30, 2014 and August 31, 2013	5
	Unaudited Consolidated Statements of Comprehensive Income (Loss) for the Thirteen and Twenty-Six Weeks ended August 30, 2014 and August 31, 2013	6
	Unaudited Consolidated Statements of Cash Flows for the Twenty-Six Weeks ended August 30, 2014 and August 31, 2013	7
	Notes to the Unaudited Consolidated Financial Statements	8
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	16
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	31
Item 4.	Controls and Procedures	31
PART II.	**OTHER INFORMATION**	
Item 1.	Legal Proceedings	32
Item 1A.	Risk Factors	32
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	32
Item 3.	Default Upon Senior Securities	32
Item 4.	Mine Safety Disclosures	32
Item 5.	Other Information	32
Item 6.	Exhibits	32

Table of Contents

The Container Store Group, Inc.

Consolidated balance sheets

(In thousands)	August 30, 2014 (unaudited)	March 1, 2014	August 31, 2013 (unaudited)
Assets			
Current assets:			
Cash	$15,298	$18,046	$12,744
Accounts receivable, net	27,732	32,273	25,013
Inventory	95,708	85,595	91,165
Prepaid expenses	9,675	14,121	10,249
Forward contracts			227
Income taxes receivable	2,257	83	2,317
Deferred tax assets, net	3,967	3,967	855
Other current assets	9,798	10,322	10,583
Total current assets	164,435	164,407	153,153
Noncurrent assets:			
Property and equipment, net	170,562	161,431	146,372
Goodwill	202,815	202,815	202,815
Trade names	237,821	242,290	240,434
Deferred financing costs, net	8,721	9,699	10,167
Noncurrent deferred tax assets, net	1,158	1,323	1,667
Other assets	1,064	1,184	855
Total noncurrent assets	622,141	618,742	602,310
Total assets	$786,576	$783,149	$755,463

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated balance sheets (continued)

(In thousands, except share and per share amounts)	August 30, 2014 (unaudited)	March 1, 2014	August 31, 2013 (unaudited)
Liabilities and shareholders equity			
Current liabilities:			
Accounts payable	$46,600	$49,282	$51,465
Accrued liabilities	56,546	60,496	51,892
Revolving lines of credit	16,779	16,033	21,215
Current portion of long-term debt	5,985	7,527	9,869
Forward contracts	486		
Income taxes payable	1,305	3,474	585
Deferred tax liabilities, net	29	29	43
Total current liabilities	127,730	136,841	135,069
Noncurrent liabilities:			
Long-term debt	343,264	327,724	361,108
Noncurrent deferred tax liabilities, net	83,555	85,442	88,228
Deferred rent and other long-term liabilities	36,469	35,956	31,492
Total noncurrent liabilities	463,288	449,122	480,828
Total liabilities	591,018	585,963	615,897
Commitments and contingencies *(Note 7)*			
Shareholders equity:			
Common stock, $0.01 par value, 250,000,000 shares authorized, 47,979,297 shares issued and outstanding at August 30, 2014; 250,000,000 shares authorized, 47,941,180 shares issued and outstanding at March 1, 2014; 3,528,280 shares authorized, 2,942,326 shares issued and 2,928,760 shares outstanding at August 31, 2013	480	479	29
Preferred stock, $0.01 par value:			
Senior cumulative; no shares authorized, issued or outstanding at August 30, 2014 and March 1, 2014; 250,000 shares authorized, 202,480 shares issued and 202,182 shares outstanding at August 31, 2013			2
Junior cumulative; no shares authorized, issued or outstanding at August 30, 2014 and March 1, 2014; 250,000 shares authorized, 202,480 shares issued and 202,182 shares outstanding at August 31, 2013			2
Additional paid-in capital	854,516	853,295	455,460
Accumulated other comprehensive (loss) income	(4,543)	1,683	(569)
Retained deficit	(654,895)	(658,271)	(314,518)
Treasury stock, no shares at August 30, 2014 and March 1, 2014;14,162 shares at August 31, 2013			(840)
Total shareholders equity	195,558	197,186	139,566
Total liabilities and shareholders equity	$786,576	$783,149	$755,463

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated statements of operations

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
(In thousands, except share and per share amounts) (unaudited)	**August 30, 2014**	**August 31, 2013**	**August 30, 2014**	**August 31, 2013**
Net sales	$193,247	$183,774	$366,685	$343,419
Cost of sales (excluding depreciation and amortization)	79,581	76,377	152,167	142,818
Gross profit	113,666	107,397	214,518	200,601
Selling, general, and administrative expenses (excluding depreciation and amortization)	90,530	85,838	181,719	169,287
Pre-opening costs	2,359	1,972	5,346	3,934
Depreciation and amortization	7,567	7,580	14,823	15,050
Restructuring charges		120		361
Other expenses	282	407	807	626
Loss on disposal of assets	114	51	214	73
Income from operations	12,814	11,429	11,609	11,270
Interest expense	4,383	5,519	8,685	11,074
Loss on extinguishment of debt				1,101
Income (loss) before taxes	8,431	5,910	2,924	(905)
Provision (benefit) for income taxes	1,476	1,803	(452)	(217)
Net income (loss)	$6,955	$4,107	$3,376	$(688)
Less: Distributions accumulated to preferred shareholders		(21,851)		(44,150)
Net income (loss) available to common shareholders	$6,955	$(17,744)	$3,376	$(44,838)
Net income (loss) per common share - basic	$0.14	$(6.06)	$0.07	$(15.31)
Net income (loss) per common share - diluted	$0.14	$(6.06)	$0.07	$(15.31)
Weighted-average common shares outstanding - basic	47,976,500	2,929,165	47,961,558	2,929,468
Weighted-average common shares outstanding - diluted	48,539,762	2,929,165	48,611,985	2,929,468

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated statements of comprehensive income (loss)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
(In thousands) (unaudited)	**August 30, 2014**	**August 31, 2013**	**August 30, 2014**	**August 31, 2013**
Net income (loss)	$6,955	$4,107	$3,376	$(688)
Unrealized loss on financial instruments, net of taxes of $238, $59, $223, and $170	(333)	(176)	(386)	(1,121)
Pension liability adjustment	59	34	120	34
Foreign currency translation adjustment	(3,158)	(269)	(5,960)	(2,195)
Comprehensive income (loss)	$3,523	$3,696	$(2,850)	$(3,970)

See accompanying notes.

Table of Contents

The Container Store Group, Inc.

Consolidated statements of cash flows

(In thousands) (unaudited)	Twenty-Six Weeks Ended August 30, 2014	August 31, 2013
Operating activities		
Net income (loss)	$3,376	$(688)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	14,823	15,050
Stock-based compensation	546	213
Excess tax benefit from stock-based compensation	(10)	
Loss on disposal of property and equipment	214	73
Deferred tax (benefit) expense	(442)	79
Noncash refinancing expense		723
Noncash interest	978	901
Changes in operating assets and liabilities:		
Accounts receivable	3,495	67
Inventory	(11,494)	(9,708)
Prepaid expenses and other assets	4,921	(174)
Accounts payable and accrued liabilities	(1,751)	5,091
Income taxes payable	(4,316)	(3,865)
Other noncurrent liabilities	844	1,573
Net cash provided by operating activities	11,184	9,335
Investing activities		
Additions to property and equipment	(30,917)	(23,049)
Proceeds from sale of property and equipment	6	389
Net cash used in investing activities	(30,911)	(22,660)
Financing activities		
Borrowings on revolving lines of credit	45,523	31,792
Payments on revolving lines of credit	(43,383)	(23,579)
Borrowings on long-term debt	25,015	105,500
Payments on long-term debt	(10,533)	(19,771)
Payment of debt issuance costs		(3,046)
Proceeds from the exercise of stock options	664	
Excess tax benefit from stock-based compensation	10	
Purchase of treasury shares		(53)
Payment of distributions to preferred shareholders		(90,000)
Net cash provided by financing activities	17,296	843
Effect of exchange rate changes on cash	(317)	(125)
Net decrease in cash	(2,748)	(12,607)
Cash at beginning of period	18,046	25,351
Cash at end of period	$15,298	$12,744

See accompanying notes.

The Container Store Group, Inc.

Notes to consolidated financial statements (unaudited)

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

August 30, 2014

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 1, 2014, filed with the Securities and Exchange Commission on May 28, 2014. 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 and include reclassifications and other adjustments, as discussed below.

Description of business

The Container Store, Inc. was founded in 1978 in Dallas, Texas, as a retailer with a mission to provide customers with storage and organization solutions through an assortment of innovative products and unparalleled customer service. As of August 30, 2014, The Container Store, Inc. operates 67 stores with an average size of approximately 19,000 selling square feet in 24 states and the District of Columbia. The Container Store, Inc. also offers all of its products directly to its customers through its website and call center. The Container Store, Inc. s wholly owned Swedish subsidiary, Elfa International AB (Elfa) designs and manufactures component-based shelving and drawer systems 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. 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). Following the Company s IPO, LGP continues to maintain a controlling interest in the ownership of the Company.

Seasonality

The Company s business is moderately seasonal in nature and, therefore, the results of operations for the twenty-six weeks ended August 30, 2014 are not necessarily indicative of the operating results for the full year. Demand is generally highest in the fourth fiscal quarter due to Our Annual elfa® Sale, and lowest in the first fiscal quarter.

Reclassifications and other adjustments

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

During the quarter ended August 30, 2014, the Company determined that it was necessary to file an amended tax return for a prior period, which resulted in a $1.8 million reduction in the provision for income taxes, as well as an increase to income taxes receivable. We evaluated the impact of the adjustment and determined that the amount was immaterial to the consolidated financial statements for the current fiscal year and prior fiscal years. As such, the entire amount was recorded during the quarter ended August 30, 2014.

Table of Contents

Recent accounting pronouncements

In June 2014, the FASB issued ASU 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period* (a consensus of the FASB Emerging Issues Task Force). The ASU clarifies that entities should treat performance targets that can be met after the requisite service period of a share-based payment award as performance conditions that affect vesting. Therefore, an entity would not record compensation expense (measured as of the grant date without taking into account the effect of the performance target) related to an award for which transfer to the employee is contingent on the entity s satisfaction of a performance target until it becomes probable that the performance target will be met. The ASU does not contain any new disclosure requirements. For all entities, the ASU is effective for reporting periods beginning after December 15, 2015. Early adoption is permitted. We currently do not have share-based payment awards with performance targets, however, our 2013 Incentive Award Plan allows for these types of awards. We expect to adopt this standard in fiscal 2016 and do not expect the adoption of this standard to have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers,* an updated standard on revenue recognition. ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using IFRS and US GAAP. 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 new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. ASU 2014-09 will be effective for the Company in the first quarter of fiscal 2017 and may be applied on a full retrospective or modified retrospective approach. The Company is still evaluating the impact of implementation of this standard on its financial statements.

2. Long-term debt and revolving lines of credit

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 $8.6 million as of August 30, 2014) term loan facility (the 2014 Elfa Term Loan Facility) and a SEK 140.0 million (approximately $20.1 million as of August 30, 2014) 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. Elfa is required to make quarterly principal payments under the 2014 Elfa Term Loan Facility in the amount of SEK 3.0 million (approximately $0.4 million as of August 30, 2014) through maturity. The 2014 Elfa Term Loan Facility bears interest at STIBOR + 1.7% and the 2014 Elfa Revolving Credit Facility bears interest at Nordea s base rate + 1.4%, and these rates are applicable until August 29, 2017, at which time the interest rates may be renegotiated at the request of either party to the agreement. Should the parties fail to agree on new interest rates, Elfa has the ability to terminate the agreement on August 29, 2017, at which time all borrowings under the agreement shall be paid in full to Nordea.

On May 13, 2014, Elfa entered into a credit facility with Nordea for SEK 15.0 million (the Short Term Credit Facility). The Short Term Credit Facility accrued interest at 2.53% and matured on August 28, 2014, at which time all borrowings under the agreement were paid in full to Nordea (approximately $2.2 million as of August 28, 2014). The total amount of borrowings available under the Short Term Credit Facility was used to pay a mortgage owed on the Poland manufacturing facility in full in the quarter ended May 31, 2014.

Table of Contents

3. Detail of certain balance sheet accounts

	August 30, 2014	March 1, 2014	August 31, 2013
Inventory:			
Finished goods	$89,787	$79,235	$83,758
Raw materials	4,419	4,677	5,064
Work in progress	1,502	1,683	2,343
	$95,708	$85,595	$91,165
Accrued liabilities:			
Accrued payroll, benefits, and bonuses	$21,122	$23,679	$18,410
Accrued transaction and property tax	8,806	7,949	8,515
Gift cards and store credits outstanding	7,162	6,900	6,323
Unearned revenue	5,375	11,338	4,486
Accrued interest	2,530	2,481	3,877
Other accrued liabilities	11,551	8,149	10,281
	$56,546	$60,496	$51,892

4. Net income (loss) per common share

Basic net income (loss) per common share is computed as net income (loss) available to common shareholders divided by the weighted-average number of common shares outstanding for the period. Net income (loss) available to common shareholders is computed as net income (loss) less accumulated distributions to preferred shareholders for the period. Diluted net income (loss) per share is computed as net income (loss) available to common shareholders divided by the weighted-average number of common shares outstanding 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. Potential dilutive securities are excluded from the computation of diluted net income (loss) per share if their effect is anti-dilutive.

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

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 30, 2014	August 31, 2013	August 30, 2014	August 31, 2013
Numerator:				
Net income (loss)	$6,955	$4,107	$3,376	$(688)
Less: Distributions accumulated to preferred shareholders		(21,851)		(44,150)
Net income (loss) available to common shareholders	$6,955	$(17,744)	$3,376	$(44,838)
Denominator:				
Weighted-average common shares outstanding basic	47,976,500	2,929,165	47,961,558	2,929,468
Weighted-average common shares outstanding diluted	48,539,762	2,929,165	48,611,985	2,929,468
Net income (loss) per common share - basic	$0.14	$(6.06)	$0.07	$(15.31)
Net income (loss) per common share - diluted	$0.14	$(6.06)	$0.07	$(15.31)

Antidilutive securities not included:	
Stock options outstanding	795,124

Table of Contents

5. Pension plans

The Company provides pension benefits to the Elfa employees in Sweden under collectively bargained pension plans, which are recorded in other long-term liabilities. The defined benefit plan provides benefits for participating employees based on years of service and final salary levels at retirement. The defined benefit plans are unfunded and approximately 2% of Elfa employees are participants in the defined benefit pension plan. Certain employees also participate in defined contribution plans for which Company contributions are determined as a percentage of participant compensation. The Company recognized total net periodic benefit cost of $388 and $630 for pension plans in the thirteen weeks ended August 30, 2014 and August 31, 2013, respectively. The Company recognized total net periodic benefit cost of $1,314 and $1,460 for pension plans in the twenty-six weeks ended August 30, 2014 and August 31, 2013, respectively.

6. Income taxes

The Company s effective income tax rate for the thirteen weeks ended August 30, 2014 was 17.5% compared to 30.5% for the thirteen weeks ended August 31, 2013. The decrease in the effective tax rate is primarily due to a $1.8 million reduction in tax expense recorded during the quarter ended August 30, 2014 primarily related to an expected refund of tax paid in a prior period, partially offset by a shift in the mix of projected domestic and foreign earnings.

The Company s effective income tax rate for the twenty-six weeks ended August 30, 2014 was (15.5%) compared to 24.0% for the twenty-six weeks ended August 31, 2013. The decrease in the effective tax rate is driven by a $1.8 million reduction in tax expense in fiscal 2014 primarily related to an expected refund of tax paid in a prior period, partially offset by the impact of an increase in pre-tax earnings from fiscal 2013 to fiscal 2014 and a change in mix between projected domestic and foreign earnings.

7. Commitments and contingencies

In connection with insurance policies, The Container Store, Inc. has outstanding standby letters of credit totaling $3,136 as of August 30, 2014.

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 effect on the Company s consolidated financial statements on an individual basis or in the aggregate.

8. Accumulated other comprehensive income

Accumulated other comprehensive income (AOCI) consists of changes in our foreign currency forward contracts, minimum pension liability, and foreign currency translation. The components of AOCI, net of tax, are shown below for the twenty-six weeks ended August 30, 2014:

Table of Contents

	Foreign currency forward contracts	Minimum pension liability	Foreign currency translation	Total
Balance at March 1, 2014	$53	$(1,153)	$2,783	$1,683
Other comprehensive (loss) income before reclassifications, net of tax	(333)	120	(5,960)	(6,173)
Amounts reclassified to earnings, net of tax	(53)			(53)
Net current period other comprehensive (loss) income	(386)	120	(5,960)	(6,226)
Balance at August 30, 2014	$(333)	$(1,033)	$(3,177)	$(4,543)

Amounts reclassified from AOCI 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 9.

9. Foreign currency forward contracts

The Company s international operations and purchases of its significant product lines from foreign suppliers are subject to certain opportunities and risks, including foreign currency fluctuations. The Company utilizes foreign currency forward exchange contracts in Swedish krona to stabilize its retail gross margins and to protect its domestic operations from downward currency exposure by hedging purchases of inventory from its wholly owned subsidiary, Elfa. During the twenty-six weeks ended August 30, 2014 and August 31, 2013, the Company used forward contracts for 27.9% and 76.4% of inventory purchases in Swedish krona, respectively. All of the Company s currency-related hedge instruments have terms from 1 to 12 months and require the Company to exchange currencies at agreed-upon rates at settlement.

The counterparties to the contracts consist of a limited number of major domestic and international financial institutions. The Company does not hold or enter into financial instruments for trading or speculative purposes. The Company records its financial hedge instruments on a gross basis and generally does not require collateral from these counterparties because it does not expect any losses from credit exposure. The Company did not have any material financial hedge instruments that did not qualify for hedge accounting treatment as of August 30, 2014, March 1, 2014 and August 31, 2013.

The Company records all foreign currency forward contracts on its consolidated balance sheet at fair value. Forward contracts not designated as hedges are adjusted to fair value through income. The Company accounts for its foreign currency hedge instruments as cash flow hedges, as defined. Changes in the fair value of the foreign currency hedge instruments that are considered to be effective, as defined, are recorded in 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 forward contracts and determined the foreign currency forward contracts were highly effective during the twenty-six weeks ended August 30, 2014 and August 31, 2013. The Company records the fair value of its unsettled foreign currency forward contracts as cash flow hedges. The Company had $486 as of August 30, 2014 in fair value of its unsettled foreign currency forward contracts recorded as total current liabilities in the accompanying consolidated balance sheets. The Company had $227 as of August 31, 2013 in fair value of its unsettled foreign currency forward contracts recorded as total current assets in the accompanying consolidated balance sheets. As of March 1, 2014, the Company had no unsettled foreign currency forward contracts.

The Company recorded $333 in accumulated other comprehensive loss at August 30, 2014. Of the $333, $38 represents an unrealized loss that has been recorded for settled forward contracts related to inventory on hand as of August 30, 2014. The Company expects the unrealized loss of $38, net of taxes, to be reclassified into earnings over the next 12 months as the underlying inventory is sold to the end consumer.

Table of Contents

The change in fair value of the Company s foreign currency forward contracts that qualify as cash flow hedges and are included in accumulated other comprehensive income (loss), net of taxes, are presented in Note 8 of these financial statements.

10. Fair value measurements

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

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

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

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

As of August 30, 2014, March 1, 2014 and August 31, 2013, 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. Foreign currency forward contracts are related to the Company s attempts to hedge foreign currency fluctuation on purchases of inventory in Swedish krona. The Company s foreign currency hedge instruments consist of over-the-counter (OTC) contracts, which are not traded on a public exchange. See Note 9 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.

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	August 30, 2014	March 1, 2014	August 31, 2013
Assets					
Nonqualified retirement plan	Level 2	Other current assets	$3,772	$3,401	$2,892
Foreign currency hedge instruments	Level 2	Forward contracts			277
Total assets			$3,772	$3,401	$3,169
Liabilities					
Nonqualified retirement plan	Level 2	Accrued liabilities	3,788	3,417	2,907
Foreign currency hedge instruments	Level 2	Forward contracts	486		
Total liabilities			$4,274	$3,417	$2,907

Table of Contents

The fair values of long-term debt were estimated using discounted cash flow analyses, quoted prices, as well as recent transactions for similar types of borrowing arrangements. As of August 30, 2014, March 1, 2014 and August 31, 2013, the carrying values and estimated fair values of the Company s long-term debt, including current maturities, were:

		August 30, 2014	
		Carrying value	**Fair value**
Senior secured term loan facility	Level 2	$326,722	$324,271
2014 Elfa term loan facility	Level 2	8,602	8,602
Revolving credit facility	Level 3	13,000	13,000
Other loans	Level 3	925	925
		$349,249	$346,798

		March 1, 2014	
		Carrying value	**Fair value**
Senior secured term loan facility	Level 2	$328,533	$330,176
Elfa term loan facility	Level 2	1,950	1,948
Other loans	Level 3	4,768	4,686
		$335,251	$336,810

		August 31, 2013	
		Carrying value	**Fair value**
Senior secured term loan facility	Level 2	$361,344	$363,151
Elfa term loan facility	Level 3	3,769	3,829
Other loans	Level 3	5,864	5,910
		$370,977	$372,890

11. Segment reporting

The Company s operating segments were determined on the same basis as how it evaluates the performance internally. The Company s two operating segments consist of TCS and Elfa. The TCS segment includes the Company s retail stores, website and call center, as well as the installation 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

Table of Contents

in TCS inventory balances at the end of the period are eliminated for consolidation purposes in the Corporate/Other column. The net sales to third parties in the Elfa column represent sales to customers outside of the United States.

Amounts in the Corporate/Other column include unallocated corporate expenses and assets, intersegment eliminations and other adjustments to segment results necessary for the presentation of consolidated financial results in accordance with generally accepted accounting principles.

In general, the Company uses the same measurements to calculate income or loss before income taxes for operating segments as it does for the consolidated company. However, interest expense related to the Senior Secured Term Loan Facility and the Revolving Credit Facility is recorded in the Corporate/Other column.

Thirteen Weeks Ended August 30, 2014	**TCS**	**Elfa**	**Corporate/ Other**	**Total**
Net sales to third parties	$174,814	$18,433	$	$193,247
Intersegment sales		12,680	(12,680)	
Interest expense, net	5	246	4,132	4,383
Income (loss) before taxes	15,441	(213)	(6,797)	8,431
Assets(1)	628,971	130,061	27,544	786,576

Thirteen Weeks Ended August 31, 2013	**TCS**	**Elfa**	**Corporate/ Other**	**Total**
Net sales to third parties	$165,320	$18,454	$	$183,774
Intersegment sales		11,651	(11,651)	
Interest expense, net	15	195	5,309	5,519
Income (loss) before taxes	14,236	(225)	(8,101)	5,910
Assets(1)	593,542	135,554	26,367	755,463

Twenty-Six Weeks Ended August 30, 2014	**TCS**	**Elfa**	**Corporate/ Other**	**Total**
Net sales to third parties	$324,543	$42,142	$	$366,685
Intersegment sales		21,148	(21,148)	
Interest expense, net	12	407	8,266	8,685
Income (loss) before taxes	15,339	38	(12,453)	2,924
Assets(1)	628,971	130,061	27,544	786,576

Twenty-Six Weeks Ended August 31, 2013	**TCS**	**Elfa**	**Corporate/ Other**	**Total**
Net sales to third parties	$302,799	$40,620	$	$343,419
Intersegment sales		19,960	(19,960)	
Interest expense, net	32	435	10,607	11,074
Income (loss) before taxes(2)	16,958	(1,375)	(16,488)	(905)
Assets(1)	593,542	135,554	26,367	755,463

(1) Tangible assets in the Elfa column are located outside of the United States. Assets in Corporate/Other include assets located in the corporate headquarters and distribution center. Assets in Corporate/Other also include deferred tax assets and the fair value of forward contracts.

(2) The Corporate/Other column includes $1,101 loss on extinguishment of debt during the twenty-six weeks ended August 31, 2013.

Table of Contents

12. Subsequent Event

On October 3, 2014, the Company completed the sale of a Norwegian subsidiary, whose primary asset was a manufacturing facility that was shut down and consolidated into a like facility in Sweden as part of Elfa s restructuring efforts in fiscal 2012. The Company received proceeds of approximately $4.2 million and recorded a gain on the sale of this subsidiary of approximately $3.3 million in the third quarter of fiscal 2014.

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. In some cases, you can identify forward-looking statements by terms such as may, will, should, expects, plans, anticipates, c intends, target, projects, contemplates, believes, estimates, predicts, potential or continue or the negative of these terms or other s expressions. These forward-looking statements 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; our dependence on a single distribution center for all of our stores; 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; our incurrence of net losses in the past and the risk that we will experience net losses in the future; risks related to our inability to obtain capital on satisfactory terms or at all; our inability to effectively manage online sales; risks related to a security breach or cyber-attack of our website or information technology systems, and other damage to such systems; effects of competition on our business; 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; 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; 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; the risk that our operating and financial performance in a given period will not meet the guidance we provided to the public; risks related to changes in estimates or projections used to assess the fair value of our intangible assets; significant increases in raw material prices or energy costs; fluctuations in our tax obligations, effective tax rate and realization of deferred tax assets; 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; increased costs of 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 1, 2014, filed with the Securities and Exchange Commission (the SEC) on May 28, 2014.

We have based these forward-looking statements largely on our current expectations and projections about future

Table of Contents

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 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 5-4-4 fiscal calendar, whereby each fiscal quarter consists of thirteen weeks grouped into one five-week month and two four-week months , and our fiscal year is the 52- or 53-week period ending on the Saturday closest to February 28. Fiscal 2014 ends on February 28, 2015, fiscal 2013 ended on March 1, 2014 and fiscal 2012 ended on March 2, 2013. The second quarter of fiscal 2014 ended on August 30, 2014 and the second quarter of fiscal 2013 ended on August 31, 2013, and both included thirteen weeks.

Overview

We are the leading specialty retailer of storage and organization products in the United States. We are the original storage and organization specialty retailer and the only national retailer solely devoted to the category. Our goal is to help provide order to an increasingly busy and chaotic world. We provide creative, multifunctional, customizable storage and organization solutions that help our customers save time, save space and improve the quality of their lives. The breadth, depth and quality of our product offerings are designed to appeal to a broad demographic, including our core customers, who are predominantly female, affluent, highly educated and busy.

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 services business. As of August 30, 2014, we operated 67 stores with an average size of approximately 19,000 selling square feet in 24 states and the District of Columbia. We also offer all of our products directly to customers through our website and call center. Our stores receive all products directly from our distribution center co-located with our corporate headquarters 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 four manufacturing facilities with two located in Sweden, one in Finland 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.

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 (categories that are only

Table of Contents

applicable to our TCS segment are noted with (*) and to our Elfa segment with (+)). For segment data, see Note 11 to our unaudited consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 30, 2014	August 31, 2013	August 30, 2014	August 31, 2013
Net sales	$193,247	$183,774	$366,685	$343,419
Cost of sales (excluding depreciation and amortization)	79,581	76,377	152,167	142,818
Gross profit	113,666	107,397	214,518	200,601
Selling, general, and administrative expenses (excluding depreciation and amortization)	90,530	85,838	181,719	169,287
Pre-opening costs*	2,359	1,972	5,346	3,934
Depreciation and amortization	7,567	7,580	14,823	15,050
Restructuring charges+		120		361
Other expenses	282	407	807	626
Loss on disposal of assets	114	51	214	73
Income from operations	12,814	11,429	11,609	11,270
Interest expense	4,383	5,519	8,685	11,074
Loss on extinguishment of debt*				1,101
Income (loss) before taxes	8,431	5,910	2,924	(905)
Provision (benefit) for income taxes	1,476	1,803	(452)	(217)
Net income (loss)	$6,955	$4,107	$3,376	$(688)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 30, 2014	August 31, 2013	August 30, 2014	August 31, 2013
Percentage of net sales:				
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales (excluding depreciation and amortization)	41.2%	41.6%	41.5%	41.6%
Gross profit	58.8%	58.4%	58.5%	58.4%
Selling, general and administrative expenses (excluding depreciation and amortization)	46.8%	46.7%	49.6%	49.3%
Pre-opening costs*	1.2%	1.1%	1.5%	1.1%
Depreciation and amortization	3.9%	4.1%	4.0%	4.4%
Restructuring charges+	0.0%	0.1%	0.0%	0.1%
Other expenses	0.1%	0.2%	0.2%	0.2%
Loss on disposal of assets	0.1%	0.0%	0.1%	0.0%
Income from operations	6.6%	6.2%	3.2%	3.3%
Interest expense	2.3%	3.0%	2.4%	3.2%
Loss on extinguishment of debt*	0.0%	0.0%	0.0%	0.3%
Income (loss) before taxes	4.4%	3.2%	0.8%	(0.2%)
Provision (benefit) for income taxes	0.8%	1.0%	(0.1%)	0.0%
Net income (loss)	3.6%	2.2%	0.9%	(0.2%)
Operating data:				
Comparable store sales growth for the period(1)*	(0.4%)	3.1%	(0.6%)	2.9%
Number of stores open at end of period*	67	61	67	61
Average ticket(2)*	$59.65	$58.81	$58.39	$57.54
Non-GAAP measures(3):				
Adjusted EBITDA(4)	$23,378	$22,128	$33,580	$32,719
Adjusted net income(5)	$5,116	$3,688	$1,537	$474
Adjusted net income per common share - diluted(5)	$0.11	$0.08	$0.03	$0.01

18

Table of Contents

(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. When a store is relocated, we continue to consider sales from that store to be comparable store sales. Net sales from our website and call center are also included in calculations of comparable store sales. The comparable store sales growth operating measure in a given period is based on merchandise orders placed in that period, which may not always reflect when the merchandise is delivered to the customer. The comparable store sales growth metric is an operating measure intended only as supplemental information and is not a substitute for net sales presented in accordance with generally accepted accounting principles.

(2) Average ticket for all periods is calculated by dividing (a) sales of merchandise by our TCS segment for that period (regardless of whether such sales are included in comparable store sales for such period) by (b) the number of transactions for that period comprising such sales. Average ticket is an operating measure intended only as supplemental information and is not a substitute for net sales presented in accordance with generally accepted accounting principles.

(3) We have presented certain non-GAAP measures 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 (loss) 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 and our board of directors to assess our financial performance. These non-GAAP measures are 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.

(4) EBITDA and Adjusted EBITDA have been presented as supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. 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.

A reconciliation of the GAAP financial measure of net income (loss) to the non-GAAP financial measures of EBITDA and Adjusted EBITDA is set forth below:

Table of Contents

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 30, 2014	August 31, 2013	August 30, 2014	August 31, 2013
Net income (loss)	$6,955	$4,107	$3,376	$(688)
Depreciation and amortization	7,567	7,580	14,823	15,050
Interest expense, net	4,383	5,519	8,685	11,074
Income tax provision (benefit)	1,476	1,803	(452)	(217)
EBITDA	20,381	19,009	26,432	25,219
Management fees(a)		250		500
Pre-opening costs*(b)	2,359	1,972	5,346	3,934
IPO costs*(c)		349		405
Noncash rent*(d)	40	311	450	702
Restructuring charges+(e)		120		361
Stock-based compensation(f)	269	114	546	213
Loss on extinguishment of debt*(g)				1,101
Foreign exchange (gains) losses(h)	21	(77)	(51)	17
Other adjustments(i)	308	80	857	267
Adjusted EBITDA	$23,378	$22,128	$33,580	$32,719

(a) Fees paid to Leonard Green and Partners, L.P. in accordance with our management services agreement, which was terminated on November 6, 2013 in association with our initial public offering (IPO).

(b) Non-capital expenditures associated with relocating stores and opening new 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.

(c) Charges incurred in connection with our IPO, which we do not expect to recur and do not consider in our evaluation of ongoing performance.

(d) 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.

(e) Includes charges incurred to restructure business operations at Elfa, including the sale of a subsidiary in Germany during fiscal 2012, which we do not consider in our evaluation of our ongoing performance.

(f) 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.

(g) Loss recorded as a result of the amendment made to the Senior Secured Term Loan Facility (as further discussed under Senior Secured Term Loan Facility below) in April 2013, which we do not consider in our evaluation of our ongoing operations.

(h) Realized foreign exchange transactional gains/losses.

(i) Other adjustments include amounts our management does not consider in our evaluation of our ongoing operations, including costs incurred in preparation for being a public company and other charges.

(5) Adjusted net income and adjusted net income per common share diluted have been presented 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 (loss) available to common shareholders before distributions accumulated to preferred shareholders, stock-based compensation and other costs in connection with our IPO, restructuring charges, impairment charges related to intangible assets, losses on extinguishment of debt, and the tax impact of these adjustments and other unusual or infrequent tax items.

Table of Contents

We define adjusted net income per common share diluted as adjusted net income divided by the number of fully diluted shares outstanding as of the end of the current fiscal period (i.e. August 30, 2014), assuming those shares were outstanding at the beginning of all periods presented. We use adjusted net income and adjusted net income per common share diluted 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.

A reconciliation of the GAAP financial measures of net income (loss) available to common shareholders and diluted net income (loss) per common share to the non-GAAP financial measures of adjusted net income and adjusted net income per common share - diluted is set forth below:

	Thirteen Weeks Ended		**Twenty-Six Weeks Ended**	
	August 30, 2014	**August 31, 2013**	**August 30, 2014**	**August 31, 2013**
Numerator:				
Net income (loss) available to common shareholders	$6,955	$(17,744)	$3,376	$(44,838)
Distributions accumulated to preferred shareholders(a)		21,851		44,150
IPO costs*(b)		349		405
Restructuring charges+(c)		120		361
Loss on extinguishment of debt*(d)				1,101
Taxes(e)	(1,839)	(888)	(1,839)	(705)
Adjusted net income	$5,116	$3,688	$1,537	$474
Denominator:				
Weighted average common shares outstanding diluted	48,539,762	2,929,165	48,611,985	2,929,468
Adjust weighting factor of outstanding shares(f)	2,797	45,613,394	17,739	45,700,256
Adjusted weighted average common shares outstanding -diluted	48,542,559	48,542,559	48,629,724	48,629,724
Adjusted net income per common share - diluted	$0.11	$0.08	$0.03	$0.01

(a) Distributions accumulated to preferred shareholders in arrears were eliminated in association with our IPO and are not considered in our evaluation of ongoing performance.

(b) Charges incurred in connection with our IPO, which we do not expect to recur and do not consider in our evaluation of ongoing performance.

(c) Includes charges incurred to restructure business operations at Elfa, including the sale of a subsidiary in Germany during fiscal 2012, which we do not consider in our evaluation of our ongoing performance.

(d) Loss recorded as a result of the amendment made to the Senior Secured Term Loan Facility in April 2013, which we do not consider in our evaluation of our ongoing performance.

(e) Tax impact of adjustments to net income (loss), as well as other unusual or infrequent tax items, including the impact of a$1.8 million reduction in tax expense recorded in fiscal 2014 related to an expected refund of tax paid in a prior period, as well as the exclusion of the impact of certain valuation allowances on deferred tax assets in fiscal 2013, which we do not consider in our evaluation of ongoing performance.

(f) Calculated based on assumption that the number of diluted shares outstanding as of the end of the current fiscal period (i.e. August 30, 2014) were outstanding at the beginning of all periods presented.

Table of Contents

Thirteen Weeks Ended August 30, 2014 Compared to Thirteen Weeks Ended August 31, 2013

Net sales

The following table summarizes our net sales for the thirteen weeks ended August 30, 2014 and August 31, 2013:

	Thirteen Weeks Ended			
	August 30, 2014	% total	August 31, 2013	% total
TCS net sales	$174,814	90.5%	$165,320	90.0%
Elfa third party net sales	18,433	9.5%	18,454	10.0%
Net sales	$193,247	100.0%	$183,774	100.0%

Net sales in the thirteen weeks ended August 30, 2014 increased by $9,473, or 5.2%, compared to the thirteen weeks ended August 31, 2013. This increase is comprised of the following components:

	Net sales
Net sales for the thirteen weeks ended August 31, 2013	$183,774
Incremental net sales increase (decrease) due to:	
New stores	9,529
Comparable stores (including a $359, or 4.7%, increase in online sales)	(901)
Elfa third party net sales	(21)
Installation services	684
Other	182
Net sales for the thirteen weeks ended August 30, 2014	$193,247

The increase in net sales was driven by new stores, with nine stores generating $9,529 of incremental sales, five of which were opened in fiscal 2013 and four of which were opened in the first half of fiscal 2014. The comparable store sales operating measure based on merchandise orders placed during the second quarter of fiscal 2014 declined 0.4%, primarily due to a decrease in transactions, and was partially offset by an increase in average ticket. This led to a decline in net sales from comparable stores based on merchandise deliveries of $901. Elfa s third party net sales increased by 3.7% in Swedish krona; however due to the depreciation of the Swedish krona against the US dollar, Elfa s third party net sales in US dollars declined slightly by 0.1%. Installation services increased by $684, due to an ongoing, focused effort to increase the number of installed spaces sold.

Gross profit and gross margin

Gross profit in the thirteen weeks ended August 30, 2014 increased by $6,269, or 5.8%, compared to the thirteen weeks ended August 31, 2013. The increase in gross profit was primarily the result of increased sales, combined with improved gross margins. The following table summarizes the gross margin for the second quarter of fiscal 2014 and fiscal 2013 by segment and total. The segment margins include the impact of inter-segment sales from the Elfa segment to the TCS segment:

	Thirteen Weeks Ended	
	August 30, 2014	August 31, 2013
TCS gross margin	59.3%	58.8%
Elfa gross margin	34.7%	36.3%
Total gross margin	58.8%	58.4%

Table of Contents

TCS gross margin increased by 50 basis points, primarily due to increased margins in non-elfa® departments, partially offset by lower margins in elfa® branded products during the second quarter. The increased margins in non-elfa® departments were due to a shift in sales mix, whereas the lower margins of elfa® branded products were due to a shift in timing of promotions during the second quarter. Elfa segment gross margin declined primarily due to a shift in sales mix. On a consolidated basis, gross margin increased 40 basis points, as the decline in Elfa gross margin was more than offset by the improvement in TCS gross margin, due to a larger percentage of net sales coming from the TCS segment.

Selling, general and administrative expenses

Selling, general and administrative expenses in the thirteen weeks ended August 30, 2014 increased by $4,692, or 5.5%, compared to the thirteen weeks ended August 31, 2013. The increase in selling, general and administrative expenses was primarily due to the increase in sales. As a percentage of consolidated net sales, selling, general and administrative expenses increased by 10 basis points. The following table summarizes selling, general and administrative expenses as a percentage of consolidated net sales for the second quarter of fiscal 2014 and fiscal 2013:

		Thirteen Weeks Ended
	August 30, 2014 **% of net sales**	**August 31, 2013** **% of net sales**
TCS selling, general and administrative	42.0%	41.8%
Elfa selling, general and administrative	4.8%	4.9%
Total selling, general and administrative	46.8%	46.7%

TCS selling, general and administrative expenses increased by 20 basis points as a percentage of total net sales. The increase was primarily due to increased costs as a result of being a public company, as well as implementation of strategic initiatives. Elfa selling, general and administrative expenses decreased by 10 basis points as a percentage of total net sales, primarily due to lower sales and marketing expenses during the quarter.

Pre-opening costs

Pre-opening costs increased by $387, or 19.6% in the thirteen weeks ended August 30, 2014 to $2,359, as compared to $1,972 in the thirteen weeks ended August 31, 2013. We opened one new store and relocated one store in each of the second quarters of fiscal 2014 and fiscal 2013; however, in fiscal 2014 we incurred increased costs due to the geographic locations of the store openings.

Interest expense

Interest expense decreased $1,136, or 20.6% in the thirteen weeks ended August 30, 2014 to $4,383 as compared to $5,519 in the thirteen weeks ended August 30, 2013, primarily due to lower interest rates and repayments on debt obligations. In November 2013, a second amendment to the Senior Secured Term Loan Facility (the Repricing Transaction) was executed, which lowered the interest rate to LIBOR + 3.25%, subject to a LIBOR floor of 1.00%. Additionally, a $31,000 repayment on the Senior Secured Term Loan Facility was made in November 2013.

Taxes

The provision for income taxes in the thirteen weeks ended August 30, 2014 was $1,476 as compared to $1,803 in the thirteen weeks ended August 31, 2013. The effective tax rate for the second quarter of fiscal 2014 was 17.5%, as compared to 30.5% in the second quarter of fiscal 2013. The decrease in the effective tax rate is primarily due to a $1.8 million reduction in tax expense recorded in fiscal 2014 primarily related to an expected refund of tax paid in a prior period, partially offset by a shift in the mix of projected domestic and foreign earnings.

Table of Contents

Twenty-Six Weeks Ended August 30, 2014 Compared to Twenty-Six Weeks Ended August 31, 2013

Net sales

The following table summarizes our net sales for the twenty-six weeks ended August 30, 2014 and August 31, 2013:

	Twenty-Six Weeks Ended			
	August 30, 2014	% total	August 31, 2013	% total
TCS net sales	$324,543	88.5%	$302,799	88.2%
Elfa third party net sales	42,142	11.5%	40,620	11.8%
Net sales	$366,685	100.0%	$343,419	100.0%

Net sales in the first half of fiscal 2014 increased by $23,266, or 6.8%, compared to the first half of fiscal 2013. This increase is comprised of the following components:

	Net sales
Net sales for the twenty-six weeks ended August 31, 2013	$343,419
Incremental net sales increase due to:	
New stores	17,634
Comparable stores (including a $1,907, or 13.6%, increase in online sales)	1,935
Elfa third party net sales	1,522
Installation services	1,769
Other	406
Net sales for the twenty-six weeks ended August 30, 2014	$366,685

The increase in net sales was driven by new stores, with nine stores generating $17,634 of incremental sales, five of which were opened in fiscal 2013 and four of which were opened in the first half of fiscal 2014. Although the comparable store sales operating measure based on merchandise orders placed during the first quarter of fiscal 2014 declined 0.6% during the first half of fiscal 2014, net sales from comparable stores based on merchandise deliveries increased by $1,935, primarily due to the weather-related extension of Our Annual elfa® Sale in the fourth quarter of fiscal 2013. This led to an increase in merchandise delivered to customers during the first half of fiscal 2014 as compared to the first half of fiscal 2013. Additionally, there was a $1,522 increase in Elfa third party net sales, which was primarily related to a promotional campaign in the first quarter of fiscal 2014, as well as improved market conditions in the Nordic market. Installation services increased by $1,769, due to an ongoing, focused effort to increase the number of installed spaces sold.

Gross profit and gross margin

Gross profit in the first half of fiscal 2014 increased by $13,917, or 6.9%, compared to the first half of fiscal 2013. The increase in gross profit was primarily the result of increased sales. The following table summarizes the gross margin for the first half of fiscal 2014 and fiscal 2013 by segment and total. The segment margins include the impact of inter-segment sales from the Elfa segment to the TCS segment:

	Twenty-Six Weeks Ended	
	August 30, 2014	**August 31, 2013**
TCS gross margin	58.8%	58.8%
Elfa gross margin	37.9%	38.3%
Total gross margin	58.5%	58.4%

Table of Contents

TCS gross margin remained consistent at 58.8% for the first half of fiscal 2014, with increased discounting of our elfa® department in the first half of fiscal 2014 primarily due to the weather related extension of Our Annual elfa® Sale in the fourth quarter of fiscal 2013, completely offset by increased gross margins in other departments. Elfa segment gross margin declined primarily due to a shift in sales mix. On a consolidated basis, gross margin increased 10 basis points, as the decline in Elfa gross margin was more than offset by the impact of TCS gross margin, due to a larger percentage of net sales coming from the TCS segment.

Selling, general and administrative expenses

Selling, general and administrative expenses in the first half of fiscal 2014 increased by $12,432, or 7.3%, compared to the first half of fiscal 2013. The increase in selling, general and administrative expenses was primarily due to the increase in sales. As a percentage of consolidated net sales, selling, general and administrative expenses increased by 30 basis points. The following table summarizes selling, general and administrative expenses as a percentage of consolidated net sales for the first half of fiscal 2014 and fiscal 2013:

		Twenty-Six Weeks Ended
	August 30, 2014 % of net sales	August 31, 2013 % of net sales
TCS selling, general and administrative	43.9%	43.4%
Elfa selling, general and administrative	5.7%	5.9%
Total selling, general and administrative	49.6%	49.3%

TCS selling, general and administrative expenses increased by 50 basis points as a percentage of total net sales. The increase was primarily due to increased costs as a result of being a public company, as well as preparation for future growth and implementation of strategic initiatives. Elfa selling, general and administrative expenses decreased by 20 basis points as a percentage of total net sales. The decrease was primarily due to lower sales and marketing expenses and favorable transactional exchange rates.

Pre-opening costs

Pre-opening costs increased by $1,412, or 35.9% in the first half of fiscal 2014 to $5,346, as compared to $3,934 in the first half of fiscal 2013. We opened four new stores and relocated one store in the first half of fiscal 2014, and we opened three new stores and relocated one store in the first half of fiscal 2013. Additionally, we incurred increased costs associated with the geographic locations of the store openings in fiscal 2014 as compared to fiscal 2013.

Interest expense

Interest expense decreased $2,389, or 21.6% in the first half of fiscal 2014 to $8,685 as compared to $11,074 in the first half of fiscal 2013, primarily due to lower interest rates and repayments on debt obligations. In April 2013, The Container Store, Inc. executed an amendment to the Senior Secured Term Loan Facility (the Increase and Repricing Transaction), whereby borrowings under the Senior Secured Term Loan Facility were increased by $90,000 and accrued interest at a lower rate of LIBOR plus 4.25%, subject to a LIBOR floor of 1.25%. Further, in

November 2013, the Repricing Transaction was executed. The Senior Secured Term Loan Facility now accrues interest at a rate of LIBOR + 3.25%, subject to a LIBOR floor of 1.00%. Additionally, a $31,000 repayment on the Senior Secured Term Loan Facility was made in November 2013.

Loss on extinguishment of debt

In the first half of fiscal 2013, we recorded expenses of $1,