



Costco Wholesale Corporation. (NASDAQ: COST)

Sector: Consumer Staples

Target Price	Current Price	52 Week High	52 Week Low	P/E	Market Cap.	Dividend Yield	Beta
\$237.55	\$211.18	\$245.16	\$175.79	28.63	\$93.02B	1.08%	1.12

Business Description

Costco Wholesale Corporation, in conjunction with its subsidiaries, owns and operates a chain of membership warehouses that offer various products including Food and Sundries, Ancillary and Other, Hardlines, Fresh Food, Softlines, and Membership fees. As of September 2, 2018, there are 768 warehouses, including 533 in the United States and Puerto Rico, 100 in Canada, and rest are in Mexico, the United Kingdom, Japan, Korea, Taiwan, Australia, Spain, Iceland, and France. The membership fee that Costco charges annually is \$60 or \$120.

Industry Trends

Overall, the consumer staples sector has underperformed due to the uncertainty over the short-term interest rate, tariffs, gas prices, and food inflation. The positive factors that may affect the industry in 2019 include aggressive cost-cutting, increase in merger and acquisition activity, increased geopolitical and domestic political anxiety, and lower energy prices. In particular, retailers have aggressively cut cost to increase sales, and a low oil price means more money available for other spendings. The negative factor that may affect the industry in 2019 includes increase competition and trade disputes. As the low-cost emerging market production continues to grow, it could shrink the pricing authority of the companies within the sector. For trade disputes, this could raise the cost for American producers and passed the increased prices to customers.

Investment Thesis

Costco will provide long term sustainable growth through (1) brand loyalty, (2) sales growth and expansion, and (3) increasing e-commerce penetration. First, customers value Costco's highly discounted products and bulk selling strategies, which positions Costco as a reputable and consistent brand. Second, the consistent same-store sales and traffic growth throughout a healthy holiday season; specifically, sales were up 7% and traffic rose 5.6% based on 2018 December comparable. Also, Costco plans to open about 23 new warehouses, including ¾ in the U.S. Third, e-commerce comparable sales advanced 46.1% in the month of November 2018, and 32.3% during the first quarter of the fiscal year 2019.

Valuation Assumptions

WACC: 9.2%
Terminal FCF Growth Rate: 3.5%
Upside: 12.50%
Sources: Bloomberg, Value Line, Annual Reports

Key Financials

Current stock price: \$211.18
Intrinsic Value: \$234.81
ROIC: 16.76%

Report Prepared By:

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Corporate Social Responsibility

Costco is committed to taking care of its employees, support the communities, operate efficiently and in an environmentally responsible manner, and strategically source the merchandise in a sustainable manner.

- Since 2012, Costco has partnered with New Eyes for the Needy, and contributed annual donations of approximately 260,000 used glasses and 1,900 hearing aides
- In the fiscal year 2018, donated over 34 million pounds of foods and provided cash contributions of \$1.75 million to Feeding America; and donated 41,945 pallets of products to World Vision

5-Year Stock Performance



Competitive Analysis

Costco's main competitors are Sam's Club division of Walmart and BJ's wholesale (private). Other competitors include Walmart, Target, Amazon, Dollar General, Five Below, and Kroger. In term of the revenue, Costco generates \$141.7B, while Sam's Club has \$59B, Amazon has \$232.9B, Walmart has \$511.9B, Target has \$52 B, Kroger has \$124.1B, and BJ's wholesale has \$3.1 B; this positioned Costco in the middle of their peers.

Competitive Advantages

Costco has two major advantages over its peers. First, Costco's high-density, low-cost business model, which allows the company to provide the best competitive price to its customers. Second, the Kirkland Signature brand, this differentiates Costco from its peers that lack private-label products. The Kirkland Signature brand accounts for 25% of total sales, which allows Costco to offer high quality at a lower price than national brands, and the margin is up to 6 percentage points above national brand that ultimately boosts Costco's overall margins.

Risks

- Heavily reliant on membership renewal and consumer preferences
- Tight margins as a result of highly discounted merchandise
- Faces competitive pricing pressure from other mass retailers or grocers, for example, Amazon and Walmart