Costco Wholesale Corporation (COST)

Updated September 26th, 2021, by Josh Arnold

Key Metrics

Current Price:	$468	**5 Year CAGR Estimate:**	4.3%	**Market Cap:**	$200 B
Fair Value Price:	$362	**5 Year Growth Estimate:**	9.0%	**Ex-Dividend Date:**	10/29/21[1]
% Fair Value:	129%	**5 Year Valuation Multiple Estimate:**	-5.0%	**Dividend Payment Date:**	11/14/21[1]
Dividend Yield:	0.7%	**5 Year Price Target**	$556	**Years Of Dividend Growth:**	18
Dividend Risk Score:	A	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	12.9%

Overview & Current Events

Costco's humble beginning in a converted airplane hangar has given way to a powerhouse in an industry it helped create. Today, Costco is a diversified warehouse retailer that operates about 800 warehouses that collectively generate about $211 billion in annual sales. Costco's leadership in this industry has rewarded shareholders handsomely over the years as it sports a $200 billion market capitalization.

Costco reported fourth quarter and full-year earnings on September 23rd, 2021, and results handily beat expectations on both the top and bottom lines. Total revenue was up more than 17% year-over-year, coming in at $61.4 billion for the fourth quarter. For the year, the company saw a similar increase, as total sales rose nearly 18% to $192 billion. Comparable sales growth was 15.5% in Q4, excluding the impact of gasoline sales and forex exchange. Including those two items, comparable sales were up 17.5%, which easily beat estimates for growth of 15.1%. In the US, comparable sales were up 14.9%, while e-commerce sales were up 11.2%. On a sequential basis, sales were up 38.5%, and membership fees were 37% higher.

Net income came to $1.6 billion in Q4, up from $1.4 billion in the year-ago period. The company noted that freight inflation appears to be permanent, and that it is taking action on pricing in some cases to help keep costs low to consumers. That means Costco will take lower profit margins in some cases, while boosting prices to consumers in others. Given this, we are starting Costco off with an initial fiscal 2022 earnings-per-share estimate of $12.05, which would represent strong growth from the recently completed year.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$3.97	$4.49	$4.65	$5.27	$5.33	$5.82	$7.09	$8.26	$9.02	$10.97	***$12.05***	***$18.54***
DPS	$1.03	$1.17	$1.33	$1.51	$1.70	$1.90	$2.14	$2.44	$2.70	$2.98	***$3.16***	***$5.09***
Shares[2]	432	437	438	438	438	437	442	443	444	444	***444***	***444***

We see Costco's forecasted growth as straightforward; sales growth will continue to make up most of its predicted growth. Its model does not allow for much in the way of expanding profit margins because its retail pricing is intended to be as low as possible for consumers. We are forecasting 9% earnings-per-share growth annually in the coming years as strong sales numbers help continue to drive incremental gains in operating margins.

The vast majority of Costco's operating margin dollars come from its membership fees, which continue to grow at strong rates, but are a very small fraction of total revenue. This is 100% margin revenue and fuels higher comparable sales, as well as more members and more people in the stores buying. The company does not buy back stock in any sort of meaningful quantity, so that is not a source of earnings growth. Steadily higher comparable sales should be enough to keep earnings growing at our forecast rate of 9% annually. Given Costco's outstanding track record of growing sales, we aren't ready to cut our growth estimate as the company thrived during the pandemic and continues to do so. Comparable sales gains were outstanding again in Q4, and although we don't expect double digit comparable sales gains

[1] Estimated date
[2] Share count in millions
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to continue, we do expect Costco to continue to take share from competitors. We note that Costco began to lap the pandemic period during fiscal Q3 2021, so comparable sales figures will be much tougher. In addition, commentary from management on margins due to rising costs is somewhat concerning, but not crimping profits as of yet.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	21.9	23.4	25.1	26.7	29.0	27.6	28.1	27.8	33.9	34.2	***38.8***	***30.0***
Avg. Yld.	1.2%	1.1%	1.1%	1.1%	1.1%	1.2%	1.1%	1.0%	0.9%	0.8%	***0.7%***	***0.9%***

Costco's price-to-earnings multiple has been elevated for some time as investors have applied a premium to the stock due to the company's excellent performance. However, that premium has made the stock quite expensive against its historical multiples and as a result, we see a meaningful headwind to annual total returns. Costco shares are now about as expensive as they've ever been, so we continue to see the stock as quite overvalued.

We see the yield as rising slightly over time as the stock could drift back towards a more normalized valuation, and as the payout continues to grow at a strong pace. We don't believe Costco will be a high-income stock anytime in the foreseeable future, but its payout growth should be robust. We note the $10 per share special dividend paid in December of 2020 as an exceptional event and not something investors should count on going forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	26%	26%	28%	28%	32%	33%	30%	30%	30%	27%	***26%***	***27%***

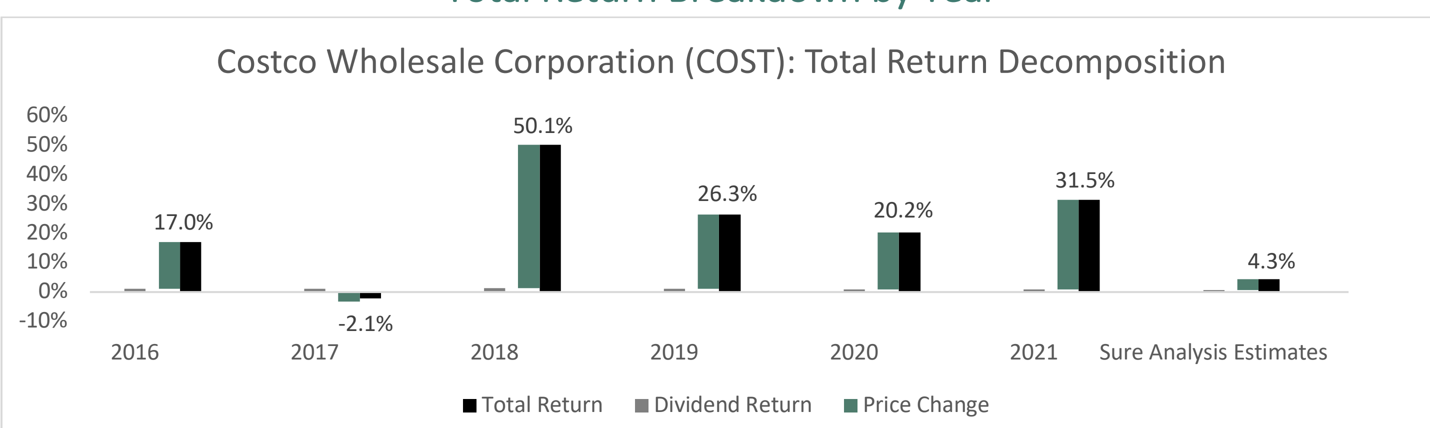
Costco's payout ratio is quite low at 26% for this year, and we believe it will remain near 30% going forward. The company has the ability to boost the dividend at a much higher rate but has thus far chosen not to. Regardless, Costco's dividend is ultra-safe, but of course, the yield is unattractive at this point.

Costco's competitive advantage is in its leadership position in a category it created and as Sam's Club closes stores, that position should strengthen. It is not immune from a recession, but damage during the last one was slight. Costco thrived during the worst of the pandemic recession and appears to have come out stronger than it entered.

Final Thoughts & Recommendation

Costco is a high growth stock that is trading well above our estimate of fair value. We see 4.3% total annual returns over the next five years, as the company's impressive growth rate could be offset by a valuation reset. We are reiterating the stock at a hold rating and note the recent rally has again deteriorated the total return outlook from our last update.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue ($B)	89	99	105	113	116	119	129	142	153	168
Gross Profit	11176	12314	13208	14182	15134	15818	17143	18424	19817	21,822
Gross Margin	12.6%	12.4%	12.6%	12.6%	13.0%	13.3%	13.3%	13.0%	13.0%	13.1%
SG&A Exp.	8691	9518	10104	10899	11445	12068	12950	13876	14994	16,332
D&A Exp.	855	908	946	1029	1127	1255	1370	1437	1492	1,645
Operating Profit	2439	2759	3053	3220	3624	3672	4111	4480	4737	5,435
Op. Margin	2.7%	2.8%	2.9%	2.9%	3.1%	3.1%	3.2%	3.2%	3.1%	3.3%
Net Profit	1462	1709	2039	2058	2377	2350	2679	3134	3659	4,002
Net Margin	1.6%	1.7%	1.9%	1.8%	2.0%	2.0%	2.1%	2.2%	2.4%	2.4%
Free Cash Flow	1908	1577	1354	1991	1892	643	4224	2805	3358	6,051
Income Tax	841	1000	990	1109	1195	1243	1325	1263	1061	1,308

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	26761	27140	30283	33024	33017	33163	36347	40830	45400	55,556
Cash & Equivalents	4009	3528	4644	5738	4801	3379	4546	6055	8384	12,277
Inventories	6638	7096	7894	8456	8908	8969	9834	11040	11395	12,242
Total Liabilities	14188	14622	19271	20509	22174	20831	25268	27727	29816	36,851
Accounts Payable	6544	7303	7872	8491	9011	7612	9608	11237	11679	14,172
Long-Term Debt	2153	1381	4998	5093	6135	5161	6573	6487	6823	7,609
Total Equity	12002	12361	10833	12303	10617	12079	10778	12799	15243	18,284
D/E Ratio	0.18	0.11	0.46	0.41	0.58	0.43	0.61	0.51	0.45	0.42

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	5.8%	6.3%	7.1%	6.5%	7.2%	7.1%	7.7%	8.1%	8.5%	7.9%
Return on Equity	12.8%	14.0%	17.6%	17.8%	20.7%	20.7%	23.4%	26.6%	26.1%	23.9%
ROIC	10.5%	11.9%	13.6%	12.2%	13.7%	13.6%	15.2%	16.8%	17.4%	16.4%
Shares Out.	434	432	437	438	438	438	437	442	443	444
Revenue/Share	200.67	225.63	238.71	254.56	262.47	269.04	292.62	320.43	344.76	375.67
FCF/Share	4.31	3.59	3.07	4.50	4.27	1.46	9.58	6.35	7.58	13.63

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.