



Costco Wholesale Corporation (COST)

Updated March 14th, 2022, by Josh Arnold

Key Metrics

Current Price:	\$527	5 Year CAGR Estimate:	4.7%	Market Cap:	\$233 B
Fair Value Price:	\$418	5 Year Growth Estimate:	9.0%	Ex-Dividend Date:	04/29/22 ¹
% Fair Value:	126%	5 Year Valuation Multiple Estimate:	-4.5%	Dividend Payment Date:	05/14/22
Dividend Yield:	0.6%	5 Year Price Target	\$643	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 \$220 billion in annual sales. Costco's leadership in this industry has rewarded shareholders handsomely over the years as it sports a \$233 billion market capitalization after a recent pullback.

Costco reported second quarter earnings on March 3rd, 2022, and results were once again better than expected, as is customary for the warehouse retailer. Total revenue was up 16% year-over-year to \$51 billion. For the first 24 weeks of the year, which is Costco's first half given its unusual fiscal year structure, sales were also up 16%, to just over \$100 billion.

Comparable sales were up 11.3% in the US for the quarter, and up 10.6% for the first half of the year. Both of those are adjusted figures that do not include fuel sales. E-commerce sales were up almost 13% on a comparable basis for both the quarter and the first half.

Net income was \$1.3 billion for the quarter, or \$2.92 per share. That was 13 cents better than expected. Last year's Q2 included 41 cents per share of costs incurred from COVID-19 premium wages. Earnings for the first half were \$2.62 billion, or \$5.90 per share. That's significantly higher than \$4.76 from the year-ago period. We now forecast \$13.05 in earnings-per-share for this year following continued strength in the company's results.

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	\$13.05	\$20.08
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
Shares²	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 Q2, particularly considering the company is lapping the surge in pandemic-related sales it saw last year. In addition, commentary from management on margins due to rising costs is

¹ Estimated date

² Share count in millions

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somewhat concerning, but not crimping profits yet. Given Costco's profits are due almost entirely to membership revenue, that is the key thing to watch. There is talk of the company's first membership fee hike in four years but hasn't yet been announced. We expect the stock would rally on such an announcement.

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	40.4	32.0
Avg. Yld.	1.2%	1.1%	1.1%	1.1%	1.1%	1.2%	1.1%	1.0%	0.9%	0.8%	0.6%	0.8%

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 much cheaper than they have been in recent months but are still very expensive.

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%	24%	25%

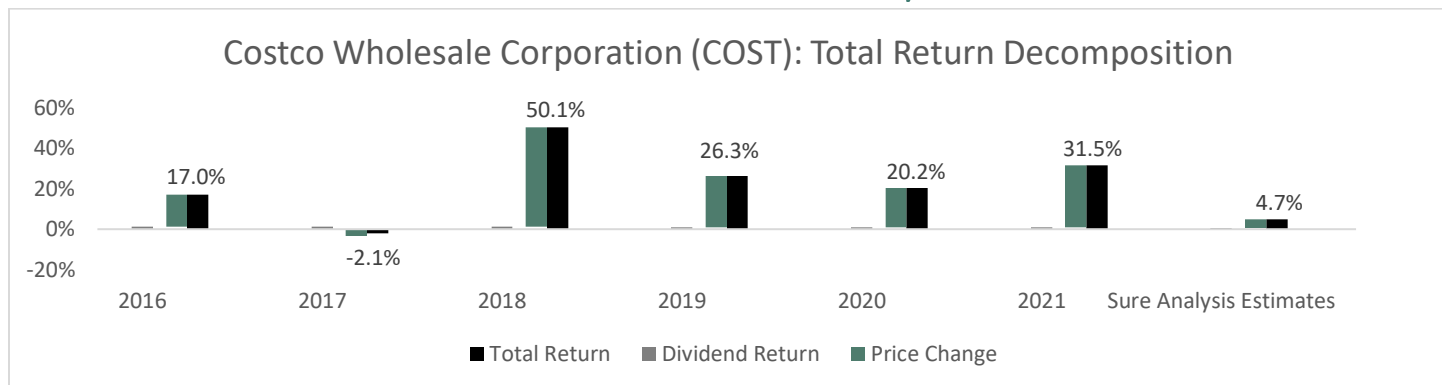
Costco's payout ratio is quite low at 24% for this year, and we believe it will remain near or under 30% going forward. The company has the ability to boost the dividend at a much higher rate but has thus far chosen not to. Regardless, Costco's dividend is ultra-safe, but of course, the yield is unattractive 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 Great Recession 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 forecast 4.7% total annual returns over the next five years, as the company's impressive growth rate could be offset by a valuation reset. The stock has pulled back since our last update, and we are now upgrading Costco from sell to hold on improved total return prospects.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue (\$B)	99	105	113	116	119	129	142	153	167	196
Gross Profit	12314	13208	14182	15134	15818	17143	18424	19817	21,822	25,245
Gross Margin	12.4%	12.6%	12.6%	13.0%	13.3%	13.3%	13.0%	13.0%	13.1%	12.9%
SG&A Exp.	9518	10104	10899	11445	12068	12950	13876	14994	16,332	18,461
D&A Exp.	908	946	1029	1127	1255	1370	1437	1492	1,645	1,781
Operating Profit	2759	3053	3220	3624	3672	4111	4480	4737	5,435	6,708
Op. Margin	2.8%	2.9%	2.9%	3.1%	3.1%	3.2%	3.2%	3.1%	3.3%	3.4%
Net Profit	1709	2039	2058	2377	2350	2679	3134	3659	4,002	5,007
Net Margin	1.7%	1.9%	1.8%	2.0%	2.0%	2.1%	2.2%	2.4%	2.4%	2.6%
Free Cash Flow	1577	1354	1991	1892	643	4224	2805	3358	6,051	5,370
Income Tax	1000	990	1109	1195	1243	1325	1263	1061	1,308	1,601

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	27140	30283	33024	33017	33163	36347	40830	45400	55,556	59,268
Cash & Equivalents	3528	4644	5738	4801	3379	4546	6055	8384	12,277	11,258
Inventories	7096	7894	8456	8908	8969	9834	11040	11395	12,242	14,215
Total Liabilities	14622	19271	20509	22174	20831	25268	27727	29816	36,851	41,190
Accounts Payable	7303	7872	8491	9011	7612	9608	11237	11679	14,172	16,278
Long-Term Debt	1381	4998	5093	6135	5161	6573	6487	6823	7,609	7,491
Total Equity	12361	10833	12303	10617	12079	10778	12799	15243	18,284	17,564
D/E Ratio	0.11	0.46	0.41	0.58	0.43	0.61	0.51	0.45	0.42	0.43

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	6.3%	7.1%	6.5%	7.2%	7.1%	7.7%	8.1%	8.5%	7.9%	8.7%
Return on Equity	14.0%	17.6%	17.8%	20.7%	20.7%	23.4%	26.6%	26.1%	23.9%	27.9%
ROIC	11.9%	13.6%	12.2%	13.7%	13.6%	15.2%	16.8%	17.4%	16.4%	19.3%
Shares Out.	432	437	438	438	438	437	442	443	444	444
Revenue/Share	225.63	238.71	254.56	262.47	269.04	292.62	320.43	344.76	375.67	440.94
FCF/Share	3.59	3.07	4.50	4.27	1.46	9.58	6.35	7.58	13.63	12.09

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

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