



Costco Wholesale Corporation (COST)

Updated December 17th, 2022, by Josh Arnold

Key Metrics

Current Price:	\$461	5 Year CAGR Estimate:	8.9%	Market Cap:	\$205 B
Fair Value Price:	\$443	5 Year Growth Estimate:	9.0%	Ex-Dividend Date:	01/28/23 ¹
% Fair Value:	104%	5 Year Valuation Multiple Estimate:	-0.8%	Dividend Payment Date:	02/13/23
Dividend Yield:	0.8%	5 Year Price Target	\$682	Years Of Dividend Growth:	19
Dividend Risk Score:	A	Retirement Suitability Score:	D	Rating:	Hold

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 850 warehouses that collectively generate about \$244 billion in annual sales. Costco's leadership in this industry has rewarded shareholders handsomely over the years as it sports a \$205 billion market capitalization.

Costco reported first quarter earnings on December 8th, 2022, and results were much weaker than expected. Adjusted earnings-per-share came to \$3.10, which was six cents below estimates. Revenue was \$54.4 billion, and while that was up 8.1% from the year-ago period, it was \$240 million lower than expectations.

Adjusted comparable sales were +6.5% in the US, +8.3% in Canada, and up 9.1% for the International business. Total company comparable sales were +7.1%, while e-commerce sales were down 2%. The consolidated comparable sales figure was also slightly lower than estimated.

Gross margins deteriorated about 50bps from the year-ago period. Given continued margin pressure, we've cut our estimate of earnings-per-share to \$14.30 from \$14.60.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$4.49	\$4.65	\$5.27	\$5.33	\$5.82	\$7.09	\$8.26	\$9.02	\$10.97	\$13.14	\$14.30	\$22.00
DPS	\$1.17	\$1.33	\$1.51	\$1.70	\$1.90	\$2.14	\$2.44	\$2.70	\$2.98	\$3.38	\$3.60	\$5.80
Shares²	437	438	438	438	437	442	443	444	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 drive incremental gains in operating margins, once this inflationary period has passed.

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 Q1, although they did miss estimates slightly. In addition, commentary from management on margins due to rising costs is somewhat concerning, and has begun to reduce profit margins. 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 sharply on such an announcement.

¹ Estimated date

² Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	23.4	25.1	26.7	29.0	27.6	28.1	27.8	33.9	34.2	40.4	32.2	31.0
Avg. Yld.	1.1%	1.1%	1.1%	1.1%	1.2%	1.1%	1.0%	0.9%	0.8%	0.6%	0.8%	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. Costco shares are now much cheaper than they've been in the past several quarters, trading for 32 times earnings. That's roughly in line with our estimate of fair value at 31 times earnings, so we see very little impact on returns from the valuation.

We see the yield as remaining roughly where it is given the fair valuation, but rising dividend payment. 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	26%	28%	28%	32%	33%	30%	30%	30%	27%	26%	25%	26%

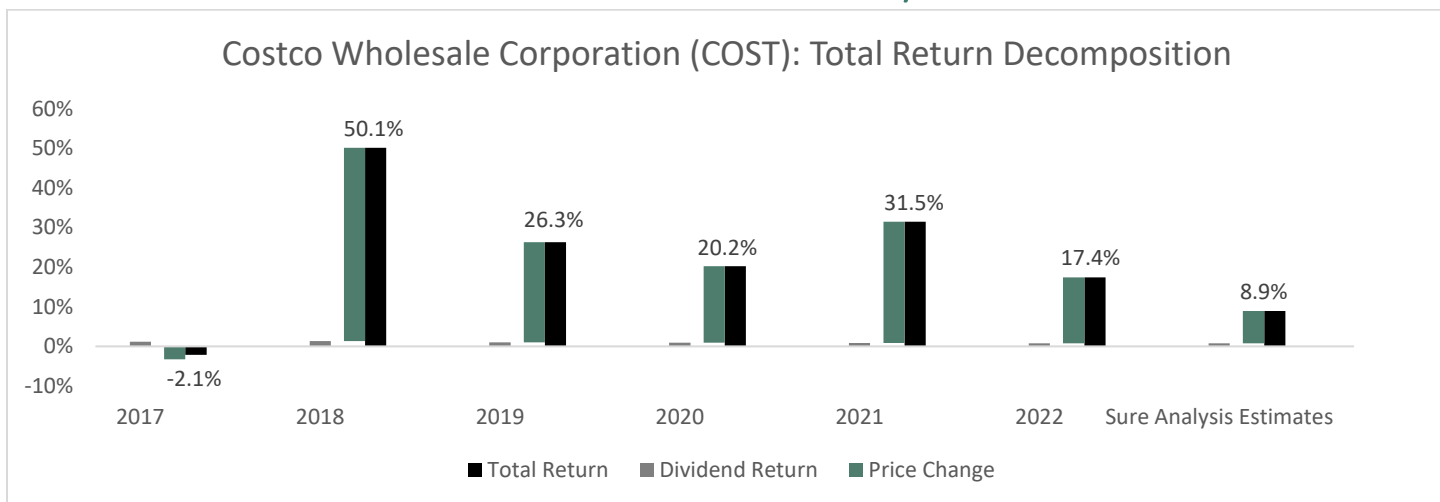
Costco's payout ratio is quite low at 25% for this year, and we believe it will remain near or under 30% going forward. The company has the ability to boost the dividend at a much higher rate but has thus far chosen not to. Regardless, Costco's dividend is ultra-safe, but of course, the yield is unattractive 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 in line with our estimate of fair value. We forecast 8.9% total annual returns over the next five years, as the company's impressive growth rate of 9% drives returns, with the 0.8% yield and modest valuation headwind offsetting each other. The stock hasn't moved much since our last update, and we are reiterating the stock at a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue (\$B)	105	113	116	119	129	142	153	167	196	227
Gross Profit	13208	14182	15134	15818	17143	18424	19817	21,822	25,245	27,572
Gross Margin	12.6%	12.6%	13.0%	13.3%	13.3%	13.0%	13.0%	13.1%	12.9%	12.1%
SG&A Exp.	10104	10899	11445	12068	12950	13876	14994	16,332	18,461	19,779
D&A Exp.	946	1029	1127	1255	1370	1437	1492	1,645	1,781	1,900
Operating Profit	3053	3220	3624	3672	4111	4480	4737	5,435	6,708	7,793
Op. Margin	2.9%	2.9%	3.1%	3.1%	3.2%	3.2%	3.1%	3.3%	3.4%	3.4%
Net Profit	2039	2058	2377	2350	2679	3134	3659	4,002	5,007	5,844
Net Margin	1.9%	1.8%	2.0%	2.0%	2.1%	2.2%	2.4%	2.4%	2.6%	2.6%
Free Cash Flow	1354	1991	1892	643	4224	2805	3358	6,051	5,370	3,501
Income Tax	990	1109	1195	1243	1325	1263	1061	1,308	1,601	1,925

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	30283	33024	33017	33163	36347	40830	45400	55,556	59,268	64,166
Cash & Equivalents	4644	5738	4801	3379	4546	6055	8384	12,277	11,258	10,203
Inventories	7894	8456	8908	8969	9834	11040	11395	12,242	14,215	17,907
Total Liabilities	19271	20509	22174	20831	25268	27727	29816	36,851	41,190	43,519
Accounts Payable	7872	8491	9011	7612	9608	11237	11679	14,172	16,278	17,848
Long-Term Debt	4998	5093	6135	5161	6573	6487	6823	7,609	7,491	6,557
Total Equity	10833	12303	10617	12079	10778	12799	15243	18,284	17,564	20,642
D/E Ratio	0.46	0.41	0.58	0.43	0.61	0.51	0.45	0.42	0.43	0.32

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	7.1%	6.5%	7.2%	7.1%	7.7%	8.1%	8.5%	7.9%	8.7%	9.5%
Return on Equity	17.6%	17.8%	20.7%	20.7%	23.4%	26.6%	26.1%	23.9%	27.9%	30.6%
ROIC	13.6%	12.2%	13.7%	13.6%	15.2%	16.8%	17.4%	16.4%	19.3%	22.1%
Shares Out.	437	438	438	438	437	442	443	444	444	445
Revenue/Share	238.71	254.56	262.47	269.04	292.62	320.43	344.76	375.67	440.94	510.29
FCF/Share	3.07	4.50	4.27	1.46	9.58	6.35	7.58	13.63	12.09	7.87

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

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