



Costco Wholesale Corporation (COST)

Updated October 2nd, 2023, by Josh Arnold

Key Metrics

Current Price:	\$571	5 Year CAGR Estimate:	7.3%	Market Cap:	\$250 B
Fair Value Price:	\$487	5 Year Growth Estimate:	10.0%	Ex-Dividend Date:	11/04/23 ¹
% Fair Value:	117%	5 Year Valuation Multiple Estimate:	-3.1%	Dividend Payment Date:	11/19/23
Dividend Yield:	0.7%	5 Year Price Target	\$784	Years Of Dividend Growth:	20
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 860 warehouses that collectively generate about \$254 billion in annual sales. Costco's leadership in this industry has rewarded shareholders handsomely over the years as it sports a \$250 billion market capitalization.

Costco posted fourth quarter and full-year earnings on September 26th, 2023, and results were better than expected on both the top and bottom lines, continuing its impressive streak of revenue and earnings growth. The company posted adjusted earnings-per-share of \$4.86, which was eight cents better than estimates. Revenue was \$78.94 billion, which was well ahead of expectations of \$77.72 billion.

Comparable sales in the fourth quarter including gasoline and currency rose 1.1%, which was light against estimates of 1.9%. Comparable sales excluding gas and forex rose 3.1%, still light against estimates of 3.3%. For the full year, revenue rose from \$222.7 billion to \$237.7 billion.

Net income on a dollar basis rose from \$1.868 billion to \$2.160 billion for the fourth quarter. For the year, earnings rose from \$5.844 billion to \$6.292 billion. We're starting fiscal 2024 with an estimate of \$15.70 in adjusted earnings-per-share, based upon continued membership fee revenue driving slightly higher profit margins.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$4.65	\$5.27	\$5.33	\$5.82	\$7.09	\$8.26	\$9.02	\$10.97	\$13.14	\$14.16	\$15.70	\$25.29
DPS	\$1.33	\$1.51	\$1.70	\$1.90	\$2.14	\$2.44	\$2.70	\$2.98	\$3.38	\$3.84	\$4.08	\$6.57
Shares²	438	438	438	437	442	443	444	444	444	443	443	443

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 10% earnings-per-share growth annually in the coming years as strong sales numbers help 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 10% 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 relatively weak in Q4, owed largely to weakness in e-commerce again. 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. We note

¹ Estimated date

² Share count in millions

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it's been six years since the company's last membership price hike, which would almost certainly cause a big rally in the stock when announced.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	25.1	26.7	29.0	27.6	28.1	27.8	33.9	34.2	40.4	34.7	36.4	31.0
Avg. Yld.	1.1%	1.1%	1.1%	1.2%	1.1%	1.0%	0.9%	0.8%	0.6%	0.7%	0.7%	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. Costco shares are now quite expensive again, trading for 36.4 times earnings. That's ahead of our estimate of fair value at 31 times earnings, so we see a modest headwind to 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	28%	28%	32%	33%	30%	30%	30%	27%	26%	27%	26%	26%

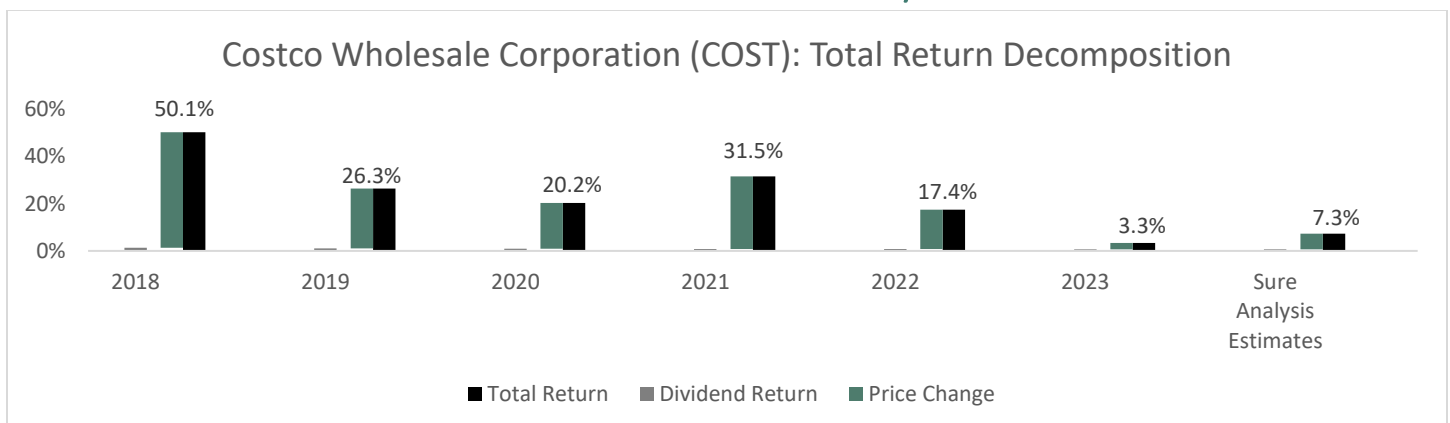
Costco's payout ratio is quite low at 26% for this year, and we believe it will remain near or under 30% going forward. The company has the ability to boost the dividend at a much higher rate but has thus far chosen not to. Regardless, Costco's dividend is ultra-safe, but of course, the yield is unattractive.

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 ahead of our estimate of fair value. We forecast 7.3% total annual returns over the next five years, as the company's impressive growth rate of 10% drives returns, with the 0.7% yield and modest valuation headwind offsetting each other. Shares offer slightly lower prospective returns than our prior update, but we reiterate a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue (\$B)	113	116	119	129	142	153	167	196	227	242
Gross Profit	14182	15134	15818	17143	18424	19817	21,822	25,245	27,572	29,704
Gross Margin	12.6%	13.0%	13.3%	13.3%	13.0%	13.0%	13.1%	12.9%	12.1%	12.3%
SG&A Exp.	10899	11445	12068	12950	13876	14994	16,332	18,461	19,779	21,590
D&A Exp.	1029	1127	1255	1370	1437	1492	1,645	1,781	1,900	2,077
Operating Profit	3220	3624	3672	4111	4480	4737	5,435	6,708	7,793	8,114
Op. Margin	2.9%	3.1%	3.1%	3.2%	3.2%	3.1%	3.3%	3.4%	3.4%	3.3%
Net Profit	2058	2377	2350	2679	3134	3659	4,002	5,007	5,844	6,292
Net Margin	1.8%	2.0%	2.0%	2.1%	2.2%	2.4%	2.4%	2.6%	2.6%	2.6%
Free Cash Flow	1991	1892	643	4224	2805	3358	6,051	5,370	3,501	6,745
Income Tax	1109	1195	1243	1325	1263	1061	1,308	1,601	1,925	2,195

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	33024	33017	33163	36347	40830	45400	55,556	59,268	64,166	68,994
Cash & Equivalents	5738	4801	3379	4546	6055	8384	12,277	11,258	10,203	13,700
Inventories	8456	8908	8969	9834	11040	11395	12,242	14,215	17,907	16,651
Total Liabilities	20509	22174	20831	25268	27727	29816	36,851	41,190	43,519	43,936
Accounts Payable	8491	9011	7612	9608	11237	11679	14,172	16,278	17,848	17,483
Long-Term Debt	5093	6135	5161	6573	6487	6823	7,609	7,491	6,557	6,458
Total Equity	12303	10617	12079	10778	12799	15243	18,284	17,564	20,642	25,058
D/E Ratio	0.41	0.58	0.43	0.61	0.51	0.45	0.42	0.43	0.32	0.26

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	6.5%	7.2%	7.1%	7.7%	8.1%	8.5%	7.9%	8.7%	9.5%	9.5%
Return on Equity	17.8%	20.7%	20.7%	23.4%	26.6%	26.1%	23.9%	27.9%	30.6%	27.5%
ROIC	12.2%	13.7%	13.6%	15.2%	16.8%	17.4%	16.4%	19.3%	22.1%	21.4%
Shares Out.	438	438	438	437	442	443	444	444	445	444
Revenue/Share	254.56	262.47	269.04	292.62	320.43	344.76	375.67	440.94	510.29	545.14
FCF/Share	4.50	4.27	1.46	9.58	6.35	7.58	13.63	12.09	7.87	15.18

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

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