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COSTCO FINANCIAL ANALYSIS

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Introduction

Costco Wholesale Corporation was founded in 1976 and is based in Issaquah, Washington. Costco operates membership warehouses. The company offers branded and private-label products in a range of merchandise categories. The company offers groceries, beverages, appliances, electronics, hardware, jewelry, gas stations, and etc. Additionally, it provides business and gold star membership services. As of Oct. 29, 2013, Costco operated 642 warehouses, including 457 in the United States and Puerto Rico, 86 in Canada, 34 in Mexico, 25 in the United Kingdom, 18 in Japan, 10 in Taiwan, 9 in Korea, and 3 in Australia. Costco also sells their products online. Throughout this paper I will be analyzing Costco's financial growth from 2008 through 2012, with the utilization of Costco's Annual Reports and financial ratios.

Success Factors

Costco achieved record sales and earnings for the 3rd consecutive year. Costco's 2012 operating performance was successful due to many factors: 1. Net sales for the 53-week fiscal year were up 11 ½ %, to \$97 billion, from the prior 52-week fiscal year sales of \$87 billion. 2. The sale results were positively impacted by increases in both shopper frequency and the average amounts spent by members on each visit. 3. Membership fees increased above 11%. 4. Gross margin decreased. 5. Costco's selling, general, and administrative expenses as a percent of net sales decreased by 17 basis points. 6. Costco's 2012 net income increased 17% to \$1.71 billion, or \$3.89, compared to \$1.46 billion or \$3.30 per share in 2011. Costco's operations, domestically and internationally generated over \$3 billion in operating cash flow.

Costco is now one of the largest retailers in the United States, and the 7th largest retailers in the world. Costco opened 17 new locations in 2012.

Products:

Costco offers top quality products well below the industry norm, for example, their hearing products. Costco's gas stations were able to increase sales to nearly 20%, even though gasoline prices were particularly volatile. Their e-commerce business generated sales exceeding \$2.1 billion.

Times Interest Earned Ratio:

The times interest earned ratio is a metric used to measure a company's ability to meet its debt responsibilities. It is calculated by taking a company's earnings before interest and taxes and dividing it by the total interest payable on bonds and other contractual debt. A high ratio can indicate that a company has an undesirable lack of debt or is paying down too much debt with earnings that could be used for other projects. Nevertheless, when the interest coverage ratio is smaller than 1, the company is not generating enough cash from its operations EBIT to meet its interests obligations. Costco's 2012 final ratio came out to be .29, which is below 1, therefore, the company is not generating enough cash from its operations EBIT to meet its interest obligations. Compared to Walmart, which has a ratio of .12, Costco is looking better with a higher ratio of 0.29. When looking at Target, it has an even lower ratio of .061, therefore, Costco came out to show that out of the three companies it generates more cash from its operations EBIT to meet its interest obligations.

Debt to Assets Ratio:

The debt ratio is the ratio of total liabilities of a business to its total assets. It is a solvency ratio and it measures the share of the assets of a business which are financed through debt. The debt ratio ranges from 0 to 1. Lower value of debt ratio is favorable and a higher

value indicates that higher portion of companies assets are claimed by its creditors which means higher risk in operation since the business would find it difficult to obtain loans for new projects. Debt ratio of 0.5 means that half of the company's assets are financed through debts. Costco's debt to assets ratio is 0.54, therefore, more than half of the company's assets are financed through debt. Compared to Walmart, which has a ratio of 0.80, Costco is looking better with a low ratio of 0.54, and lower value of debt ratio is more favorable. When looking at Target, it also has a high ratio of 0.90. Therefore, Costco has the most favorable ratio out of the three companies.

Dividend Payout:

The dividend payout ratio is the fraction of net income a firm pays to its stockholders in dividends. The part of earnings not paid to investors is left for investment to offer for future earnings growth. High growth firms in early life normally have low or zero payout ratios. This ratio offers valuable understanding into a company's dividend policy and can also demonstrate whether those payments appear "safe" or are in danger of possibly being condensed. Costco's payout ratio is 26%, therefore, it is in good condition. It is not too high nor too low. High payouts are rarely sustainable and should warn investors that a dividend cut may be on the horizon. Walmart on the other hand holds a higher payout of 32%, therefore it is closer to the danger zone, but is still ok. Target and Costco have the same payout ratio of 26%, therefore, they are in better condition than Walmart is.

Dividend Yield:

The dividend yield is a financial ratio that shows how much a company pays out in dividends each year in relation to its share price. In the absence of any capital gains, dividend

yield is the return on investment for a stock. It shows you how much cash flow you are getting for each dollar invested in an equity position. Costco has a dividend yield of 1%, yes it is low, and however, your decision on choosing a stock should not be completely based on a low dividend yield. It is much more important to know whether the dividend is secure and will be paid in the future than just the current dividend yield. Walmart has a dividend yield of 2.44% and Target has a yield of 1.72%. Out of the three companies Costco has the lowest dividend yield, therefore, not as lucrative in the investor's eyes, however, it balances out with its other ratios leaning towards the more positive side.

Annual Growth Rate in Earnings:

The earnings growth is the annual rate of growth of earnings from investments. Generally, the greater the earnings growth, the better it is. On a side note, when the dividend payout ratio is the same, the dividend growth rate is equal to the earnings growth rate. Costco's annual growth rate in earnings for 2012 is 17.88% which is looking pretty good for Costco because compared to 2011 it increased about 5%. Therefore, looking positive in investor's eyes. Walmart's annual growth rate for 2012 is 1.12%, which is extremely low, and looking very bad for investors. Target also ending 2012 with a low rate of 7%. Therefore, Costco again seems to be the more prominent looking company.

Average Annual Growth Rate in Earnings:

The average annual growth rate is the average increase in the value of an individual investment or portfolio over the period of a year. On average Walmart has the better rate of 10.77%, compared to Costco and Target, which have rates of 10.42% and 5.92%, respectively.

Earnings per Share:

Earnings per share is the portion of a company's profit allocated to each outstanding share of common stock. It serves as an indicator of a company's profitability. It is generally considered to be the most single important factor in determining a share's price. Costco's earnings per share have increased every year since 2008, and 2012 ended with \$3.89 earnings per share. Which gives us a positive view of Costco's stock. Walmart has an earnings per share of \$4.52 and Target has an EPS of \$4.28. Therefore, Walmart ends 2012 with the larger return of earnings. Overall, Costco's 2012 net income increased 17% to \$1.71 billion, or \$3.89 per share, compared to \$1.46 billion or \$3.30 per share in 2011. These were the best results in Costco's 29-year history.

Dividends per Share:

Dividends per share is the sum of declared dividends for every ordinary share issued. DPS is the total dividends paid out over an entire year divided by the number of outstanding ordinary shares issued. Costco ended 2012 with a 1.03 dividend per share. Compared to Walmart and Target, Costco has the lowest value for DPS. Walmart ended with 1.36 DPS and Target 1.10 DPS.

Expansion of Public Health Insurance Programs:

States are obligatory to expand Medicaid to all non-Medicare eligible individuals under the age of 65 with incomes up to 133% Federal Poverty Level (FPL) based on modified adjusted gross income. Under current law, undocumented immigrants are not eligible for Medicaid. All newly eligible adults will be guaranteed a benchmark benefit package. However, the Supreme Court made the decision to expand Medicaid optional for states.

Financial Policy Enhancements:

From 2008 till 2012, Costco's Times Interest Earned ratio has only increased. The debt to assets ratio for Costco has been somewhat consistent. Their dividend payout ratio again stayed consistent since 2009, however, had a .07 increase from 2008 to 2009. Costco's dividend yield stayed very consistent. Its annual growth rate decreased dramatically from 2008 to 2009, down to a negative, however, in 2009 increased radically from -14.53% to 18.22% then decreased again in 2011 and increased to 17.88% in 2012. Their average annual growth rate looked very good in 2008 then decreased in 2009 and continued to increase after that, showing a positive outlook. Their earnings per share has been increasing since 2009. Finally, their dividends per share have been increasing since 2008, from 0.61 to 1.03 in 2012. Costco seems to be walking up rather than down, therefore, their financial policies seem to be working for their benefit and their investors benefit. Overall, their financial policies have enhanced shareholders value. Their policies are in the benefit of all, they have very good customer service and their employees are the highest paid in the industry. Year over year, Costco Wholesale Corporation has been able to grow revenues from \$99.1B USD to \$105.2B USD. Most impressively, the company has been able to reduce the percentage of sales devoted to cost of goods sold from 87.58% to 87.44%. This was a driver that led to a bottom line growth from \$1.7B USD to \$2.0B USD.

Interest expense for the quarter increased primarily due to a \$3.5 billion debt offering that was undertaken in relation to the \$7 per share of special dividend. As of now there were no changes in Costco's financial policies.

Ratio's: Costco vs. Walmart and Target

Costco-Chosen Company	2012	2011	2010	2009	2008
Times Interest Earned (TIE)	29.04	21.03	18.71	16.45	19.18
Debt to Assets	0.54	0.53	0.54	0.54	0.55
Dividend Payout	0.26	0.27	0.26	0.28	0.21
Dividend Yield	1.08%	1.11%	1.10%	1.18%	1.19%
Annual Growth Rate in Earnings	17.88%	13.01%	18.22%	-14.53%	21.94%
Average Annual Growth Rate in Earnings	10.42%	7.49%	6.02%	5.95%	13.56%
Earnings Per Share	3.89	3.30	2.92	2.47	2.89
Dividends Per Share	1.03	0.89	0.77	0.68	0.61
Walmart	2012				
Times Interest Earned (TIE)	11.51				
Debt to Assets	0.8				
Dividend Payout	0.32				
Dividend Yield	2.44%				
Annual Growth Rate in Earnings	1.12%				
Average Annual Growth Rate in Earnings	10.77%				
Earnings Per Share	4.52				
Dividends Per Share	1.46				
Target	2012				
Times Interest Earned (TIE)	6.13				
Debt to Assets	0.9				
Dividend Payout	0.26				
Dividend Yield	1.72%				
Annual Growth Rate in Earnings	7%				
Average Annual Growth Rate in Earnings	5.92%				
Earnings Per Share	4.28				
Dividends Per Share	1.1				

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