

Costco Wholesale (COST)

\$304.68 (As of 01/17/20)

Price Target (6-12 Months): **\$323.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/06/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: C

Growth: A

Momentum: B

Summary

Shares of Costco have risen and outpaced the industry in a year. The company's growth strategies, better price management, sturdy comps performance and strong membership trends reinforce its position. We believe that the company's business model and commitment toward opening membership warehouses will continue to drive traffic. Moreover, with the wave of digital transformation, Costco is rapidly adopting the omni-channel mantra to provide a seamless shopping experience, whether online or in-stores. Such concerted efforts have been favoring comps, which remain one of the key factors behind incremental sales. Comps grew 9%, while sales improved 10.5% during month of December. However, any higher investments or aggressive pricing strategy may hurt margins. Moreover, rising SG&A expenses and stiff competition also pose concerns.

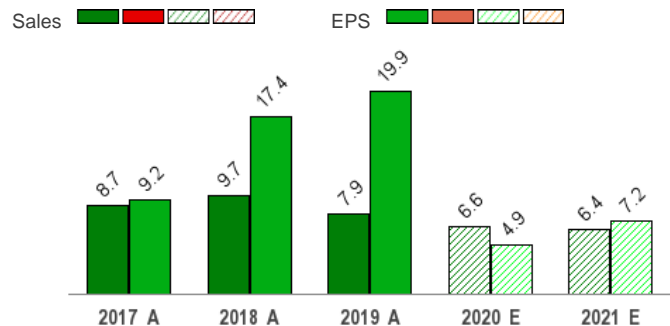
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$307.34 - \$205.75
20 Day Average Volume (sh)	1,752,261
Market Cap	\$134.6 B
YTD Price Change	3.7%
Beta	0.89
Dividend / Div Yld	\$2.60 / 0.9%
Industry	Retail - Discount Stores
Zacks Industry Rank	Top 18% (45 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.8%
Last Sales Surprise	-0.8%
EPS F1 Est- 4 week change	0.1%
Expected Report Date	03/05/2020
Earnings ESP	-0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	39,931 E	41,472 E	40,328 E	55,319 E	173,293 E
2020	37,040 A	38,272 E	37,273 E	50,863 E	162,795 E
2019	35,069 A	35,396 A	34,740 A	47,498 A	152,703 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.90 E	\$2.28 E	\$2.21 E	\$3.02 E	\$9.21 E
2020	\$1.73 A	\$2.05 E	\$2.00 E	\$2.83 E	\$8.59 E
2019	\$1.61 A	\$2.01 A	\$1.89 A	\$2.69 A	\$8.19 A

*Quarterly figures may not add up to annual.

P/E TTM	36.6
P/E F1	35.5
PEG F1	4.0
P/S TTM	0.9

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/17/2020. The reports text is as of 01/21/2020.

Overview

Based in Issaquah, Washington, Costco Wholesale Corporation sells high volumes of foods and general merchandise (including household products and appliances) at discounted prices through membership warehouses. It is one of the largest warehouse club operators in the United States. The company also operates e-commerce websites in the U.S., Canada, Mexico, U.K., Korea, Taiwan and Japan.

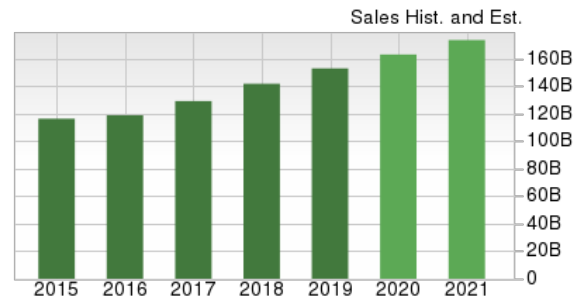
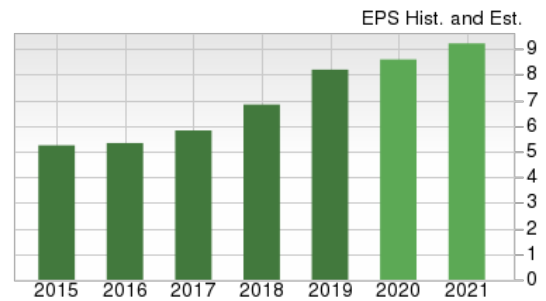
The company's warehouses offer an array of low-priced nationally branded and select private labeled products in a wide range of merchandise categories. Costco offers three types of memberships to its customers: Business, Gold Star (individual), and Executive.

As of January 8, 2019, Costco operates 785 warehouses, comprising 546 in the United States and Puerto Rico, 100 in Canada, 39 in Mexico, 29 in the United Kingdom, 26 in Japan, 16 in Korea, 13 in Taiwan, 11 in Australia, two in Spain, one each in Iceland, France and China.

Costco generates revenue from two sources: 1) Store sales (Net sales; 97.8% of fiscal 2019 total revenue) and 2) Membership fees (MFI; 2.2% of fiscal 2019 total revenue).

Costco offers myriad varieties of food products as well as a vast range of household and lifestyle products, stationeries and appliances. The company also sells gasoline to customers at cheap prices and offers merchandise in the following categories:

- 1) Food and Sundries (including dry foods, packaged foods, groceries, snack foods, candy, alcoholic and nonalcoholic beverages, and cleaning supplies)
- 2) Hardlines (including major appliances, electronics, health and beauty aids, hardware, and garden and patio)
- 3) Fresh Foods (including meat, produce, deli, and bakery)
- 4) Softlines (including apparel and small appliances)
- 5) Ancillary (including gasoline and pharmacy businesses).



Reasons To Buy:

▲ **Impressive Comps Performance Help Lift Stock:** In the evolving retail ecosystem, Costco has been able to create a niche for itself on the back of growth strategies, better price management, strong membership trends and increasing penetration of e-commerce business. Certainly, these helped the company to continue with its decent comparable sales run. Definitely, improving job prospects and rising disposable income have also aided the performance. Investors are encouraged by the company's healthy comparable sales and sales run. Markedly, shares of the company have rallied 43.4% in a year compared with the industry's rise of 37.1%.

Notably, comparable sales for the month of December rose 9% following an increase of 5.3% in November, 5.7% in October and 4.2% in September. Meanwhile, net sales improved 10.5% in December, following an increase of 6.7%, 6.8% and 5.6% in November, October and September, respectively. For the 12-week first-quarter fiscal 2020 ended Nov 24, net sales increased 5.6%, while comps improved 4.3%. Certainly, these metrics underline the sound fundamentals. Evidently, Costco's revenues have been steadily growing year on year every quarter for a while.

The company's strategy to sell products at heavily discounted prices has helped it to remain on a growth track as cash-strapped customers continue to reckon Costco as a viable option for low-cost necessities.

▲ **A Dominant Warehouse Retailer:** We believe that Costco continues to be one of the dominant retail wholesalers based on the breadth and quality of merchandise offered. The company's strategy to sell products at heavily discounted prices has helped it to remain on a growth track as cash-strapped customers continue to reckon Costco as a viable option for low-cost necessities. Costco is employing the Zest Fresh solution to augment its Fresh Food Supply Chain. Zest Fresh lower waste by 50%, increase shelf life of the food and allows the company to offer low prices on fresh food. A differentiated product range enables Costco to provide an upscale shopping experience for its members, resulting in market share gains and higher sales per square foot.

▲ **Increasing E-Commerce Penetration:** The company is also gradually expanding its e-commerce capabilities in the U.S., Canada, U.K., Mexico, Korea, Taiwan and Japan. To drive its online sales further, Costco launched new delivery services for its customers, one CostcoGrocery option to deliver non-perishable items to buyer's home within two days of ordering and another same day grocery delivery service in collaboration with Instacart. These delivery systems have been yielding favorably and driving more traffic. The company during the first quarter of fiscal 2020 launched same day prescription Rx delivery and same-day alcohol delivery through Instacart. We note that e-commerce comparable sales advanced 5.5% during the quarter and 43.1% during the month of December. Going ahead, the company plans to continue improving online merchandise and discovering ways to further enrich shopping experience.

▲ **Maximize Shareholders' Return:** Costco continues to make prudent use of its cash flow through share repurchases and dividend payments. During the fourth quarter, the company bought back shares worth of \$52 million bringing the total to \$247 million in fiscal 2019. In the past, the company had repurchased shares worth of \$322 million in fiscal 2018, \$473 million in fiscal 2017, \$477 million in fiscal 2016 and \$493 million in fiscal 2015. In April 2019, the company hiked its quarterly dividend by 14% to 65 cents a share. The board also reauthorized a share repurchase program of up to \$4 billion, which will expire in April 2023. Moreover, the company's current resources are reasonably adequate to support expenditures associated with its ongoing expansion initiatives.

▲ **Concentrating on Enhancing Global Footprint:** We are also encouraged by the company's expansion strategy. Costco has one of the highest square footage growth in the industry, and remains committed to opening new clubs in the domestic and international markets. In our view, the company's diversification strategy is a natural hedge against risks that may arise in specific markets. The company opened 23, 29, 26, 21 and 25 locations in fiscal 2015, 2016, 2017, 2018 and 2019, respectively. During the first quarter of fiscal 2020, the company had three new openings in the United States — business center in Dallas, Texas and two additional Costco warehouses in Connecticut and Minnesota. The company also relocated one unit in Canada. The company plans to open more or less net new 20 units in fiscal 2020.

Reasons To Sell:

- ▼ **Q1 Sales Miss Consensus Mark:** Although the company registered fourth straight quarter of positive earnings surprise, when it reported first-quarter fiscal 2020 results, total revenues fell short of the Zacks Consensus Estimate, after surpassing the same in the preceding quarter. With Thanksgiving happening a week later this year compared with the prior year, total and comparable sales were adversely impacted by roughly 0.5%. Moreover, management highlighted that e-commerce sales were affected by an estimated 12 percentage points.
- ▼ **Stock Looks Little Stretched:** Considering price-to-earnings (P/E) ratio, Costco looks pretty overvalued when compared with the industry as well as the S&P 500. The stock has a trailing 12-month P/E ratio of 36.62, which is above the median level of 34.73 but below the high level of 37.68 scaled in the past one year. On the contrary, the trailing 12-month P/E ratio for the industry and the S&P 500 is 26.30 and 20.83, respectively.
- ▼ **Stiff Competition:** Costco faces stiff competition from BJ's Wholesale Club and Sam's Club, a division of Wal-Mart Stores. These two rivals follow similar business models as they market high volumes of merchandise at low prices in a membership-only warehouse clubs. Sam's Club, in particular, poses the biggest threat to Costco as both primarily target professionals and small-business owners who typically make bulk purchases. Analysts pointed that any incremental investments or aggressive pricing strategy may hurt margins.
- ▼ **Rising SG&A Expenses May Strain Margins:** We note that SG&A expenses and merchandise costs increased 7.4% and 5.3%, respectively, during the first quarter of fiscal 2020. In the first, second, third and fourth quarters of fiscal 2019, SG&A expenses rose 7.8%, 7.1%, 6.8% and 9.9%, while merchandise costs rose 10.9%, 6.9%, 7.5% and 6.8%, respectively.
- ▼ **Macroeconomic Headwinds:** The company's customers are very sensitive to macroeconomic factors including interest rate hikes, increase in fuel and energy costs, sluggishness in the housing market, unemployment levels, and high household debt levels, which may affect their spending levels. Moreover, due to exposure to international markets, Costco remains prone to currency fluctuations.

Stiff competition from both brick-and-mortar stores and online retailers and cautious consumer spending may hurt Costco's performance. Moreover, it remains prone to currency fluctuations.

Last Earnings Report

Costco Earnings Beat Estimates in Q1, Increase Y/Y

Costco Wholesale Corporation posted fourth straight quarter of positive earnings surprise, when it reported first-quarter fiscal 2020 results. However, total revenues fell short of the Zacks Consensus Estimate, after surpassing the same in the preceding quarter.

With Thanksgiving happening a week later this year compared with the prior year, total and comparable sales were adversely impacted by roughly 0.5%. Moreover, management highlighted that e-commerce sales were affected by an estimated 12 percentage points.

Nonetheless, both the top and the bottom line continued to register year-over-year improvement. The company also delivered decent comparable sales growth across all regions.

Costco's better price management and strong membership trends have been playing a crucial role in driving comparable sales.

Q1 Earnings & Sales Picture

Excluding tax benefit related to stock-based compensation, this Issaquah, WA-based company reported adjusted earnings of \$1.73 per share. The quarterly earnings not only came ahead of the Zacks Consensus Estimate of \$1.70 but also improved 8% from the year-ago quarter figure.

Total revenues, which include net sales and membership fee, came in at \$37,040 million, up 5.6% from the prior-year quarter's figure. However, the figure missed the Zacks Consensus Estimate of \$37,332 million.

Weakening of foreign currencies relative to the U.S. dollar adversely impacted sales by approximately 30 basis points and gasoline price deflation negatively impacted sales by approximate 40 basis.

In the reported quarter, the company's e-commerce comparable sales rose 5.5% year over year. Excluding the effect of gasoline prices and foreign exchange, the same exhibited an improvement of 5.7% year over year.

With the prevailing trend of digital transformation in the sector, retailers are rapidly adopting the omni-channel mantra to provide a seamless shopping experience online and in stores. Costco is also following the trend. Costco operates e-commerce sites in the United States, Canada, the U.K., Mexico, Korea, Taiwan, and Japan.

Delving Deeper

Costco's net sales grew 5.6% to \$36,236 million, while membership fee increased 6.1% to \$804 million. Comparable sales for the reported quarter improved 4.3%, reflecting an increase of 4.7%, 2.9% and 3.2% in the United States, Canada and Other International locations, respectively.

Excluding the impact of foreign currency fluctuations and gasoline prices, the company witnessed comparable sales growth of 5% during the quarter. Notably, the United States, Canada and Other International locations registered comparable sales growth of 5%, 5.1% and 4.5%, respectively.

Traffic or shopping frequency rose 3.4% globally and 3.1% in the United States. Average transaction improved 0.9% on a year-over-year basis. Operating income in the quarter increased 11.8% year over year to \$1,061 million, while operating margin (as a percentage of total revenues) expanded 20 bps to 2.9%.

Store Update

Costco currently operates 785 warehouses, comprising 546 in the United States and Puerto Rico, 100 in Canada, 39 in Mexico, 29 in the U.K., 26 in Japan, 16 in Korea, 13 in Taiwan, 11 in Australia, two in Spain, one each in Iceland, France and China.

During the quarter, the company had three new openings in the United States — business center in Dallas, Texas and two additional Costco warehouses in Connecticut and Minnesota. The company also relocated one unit in Canada. The company plans to open more or less net new 20 units in fiscal 2020.

Financial Aspects

Costco ended the reported quarter with cash and cash equivalents of \$9,027 million and long-term debt (excluding current portion) of \$5,107 million. The company's shareholders' equity was \$15,861 million, excluding non-controlling interests of \$363 million.

Management incurred capital expenditures of \$700 million during the quarter under review, and plans to spend approximately \$3 billion during the fiscal year.

Quarter Ending **11/2019**

Report Date	Dec 12, 2019
Sales Surprise	-0.78%
EPS Surprise	1.76%
Quarterly EPS	1.73
Annual EPS (TTM)	8.32

Recent News

Costco's December Comps Rise 9% - January 8, 2020

Costco's comps for the month of December rose 9%. Comps for December reflect an increase of 9.4% in the United States, 9% in Canada and 7.5% in Other International locations, respectively. Meanwhile, net sales improved 10.5% to \$17.04 billion in the month under review. E-commerce comps surged 43.1% during the month.

Valuation

Costco shares are up 43.4% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are up 37.1% and 20.6%, respectively, over the past year. The S&P 500 index is up 25.6% in the past year.

The stock is currently trading at 34.5X forward 12-month earnings, which compares to 23.48X for the Zacks sub-industry, 25.64X for the Zacks sector and 19.19X for the S&P 500 index.

Over the past five years, the stock has traded as high as 36.89X and as low as 23.46X, with a 5-year median of 27.15X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$323 price target reflects 36.57X forward 12-month earnings.

The table below shows summary valuation data for COST

Valuation Multiples - COST					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	34.5	23.48	25.64	19.19
	5-Year High	36.89	23.75	26.23	19.34
	5-Year Low	23.46	17.95	19.07	15.17
	5-Year Median	27.15	20.04	22.95	17.44
P/S F12M	Current	0.81	1.38	1.09	3.57
	5-Year High	0.86	1.39	1.11	3.57
	5-Year Low	0.46	0.94	0.8	2.54
	5-Year Median	0.57	1.12	0.91	3
EV/EBITDA TTM	Current	21.62	19.1	15.6	12.38
	5-Year High	21.62	19.31	15.6	12.86
	5-Year Low	12.73	11.12	10.37	8.48
	5-Year Median	14.45	13.47	12.38	10.67

As of 01/20/2020

Industry Analysis Zacks Industry Rank: Top 18% (45 out of 254)



Top Peers

Target Corporation (TGT)	Outperform
Amazon.com, Inc. (AMZN)	Neutral
Big Lots, Inc. (BIG)	Neutral
Burlington Stores, Inc. (BURL)	Neutral
Dollar General Corporation (DG)	Neutral
Tuesday Morning Corp. (TUES)	Neutral
Walmart Inc. (WMT)	Neutral
Dollar Tree, Inc. (DLTR)	Underperform

Industry Comparison Industry: Retail - Discount Stores				Industry Peers		
	COST Neutral	X Industry	S&P 500	DG Neutral	DLTR Underperform	TGT Outperform
VGM Score	A	-	-	C	A	B
Market Cap	134.59 B	18.35 B	24.65 B	40.22 B	21.67 B	59.25 B
# of Analysts	10	9	13	23	6	12
Dividend Yield	0.85%	0.83%	1.73%	0.81%	0.00%	2.26%
Value Score	C	-	-	C	C	B
Cash/Price	0.08	0.03	0.04	0.01	0.02	0.02
EV/EBITDA	20.62	16.68	14.11	19.62	11.92	10.74
PEG Ratio	3.96	2.18	2.08	2.08	2.11	2.44
Price/Book (P/B)	8.30	5.13	3.39	6.05	3.54	5.13
Price/Cash Flow (P/CF)	26.17	17.20	13.81	20.32	4.63	11.40
P/E (F1)	35.47	23.79	19.19	23.75	19.38	18.42
Price/Sales (P/S)	0.87	0.82	2.69	1.48	0.92	0.76
Earnings Yield	2.82%	4.20%	5.21%	4.21%	5.16%	5.43%
Debt/Equity	0.47	1.33	0.72	1.57	1.33	1.10
Cash Flow (\$/share)	11.64	6.08	6.94	7.77	19.78	10.25
Growth Score	A	-	-	B	A	B
Hist. EPS Growth (3-5 yrs)	11.29%	11.35%	10.56%	13.32%	18.83%	7.70%
Proj. EPS Growth (F1/F0)	4.86%	8.76%	7.57%	11.43%	-13.33%	17.80%
Curr. Cash Flow Growth	14.92%	12.70%	14.73%	25.19%	163.96%	5.59%
Hist. Cash Flow Growth (3-5 yrs)	10.65%	7.44%	9.00%	8.34%	43.00%	2.16%
Current Ratio	1.01	1.12	1.24	1.12	1.09	0.83
Debt/Capital	31.75%	57.13%	42.99%	61.12%	57.13%	52.42%
Net Margin	2.42%	4.18%	11.14%	6.09%	-6.82%	4.18%
Return on Equity	24.22%	24.22%	17.16%	25.53%	20.85%	28.22%
Sales/Assets	3.37	1.87	0.55	1.38	1.30	1.86
Proj. Sales Growth (F1/F0)	6.61%	4.16%	4.16%	8.27%	3.83%	4.16%
Momentum Score	B	-	-	F	B	F
Daily Price Chg	0.54%	-0.19%	0.27%	-0.18%	0.52%	0.52%
1 Week Price Chg	1.89%	-0.71%	0.39%	-1.40%	-1.81%	-0.02%
4 Week Price Chg	3.73%	0.20%	2.95%	0.63%	-0.60%	-9.15%
12 Week Price Chg	2.57%	4.30%	7.76%	-3.02%	-20.80%	6.05%
52 Week Price Chg	44.08%	14.50%	22.29%	40.72%	-3.19%	68.55%
20 Day Average Volume	1,752,261	1,232,801	1,536,375	1,767,002	2,716,212	4,992,085
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.40%
(F1) EPS Est 4 week change	0.10%	0.00%	0.00%	0.02%	-0.16%	-0.40%
(F1) EPS Est 12 week change	0.51%	0.64%	-0.40%	0.64%	-6.22%	3.29%
(Q1) EPS Est Mthly Chg	0.27%	0.00%	0.00%	-0.23%	-0.35%	-1.89%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	A
Momentum Score	B
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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