



UConn Student Managed Fund

Costco Wholesale Corporation (NASDAQ: COST)

NOVEMBER 8, 2021

Target Price: \$564.51
 Current Price: \$503.81
 Stop loss: \$403.05
 52 Week High/Low: \$307.00/\$520.21

Market Cap (\$B): \$222.595B
 Dividend Yield: 0.62%
 Beta: 0.76
 ROE: 27.62%

P/E Ratio (TTM): 44.70
 EV/EBITDA: 26.03
 EBITDA Margin: 4.33%
 Gross Margin: 12.88%

Company Overview

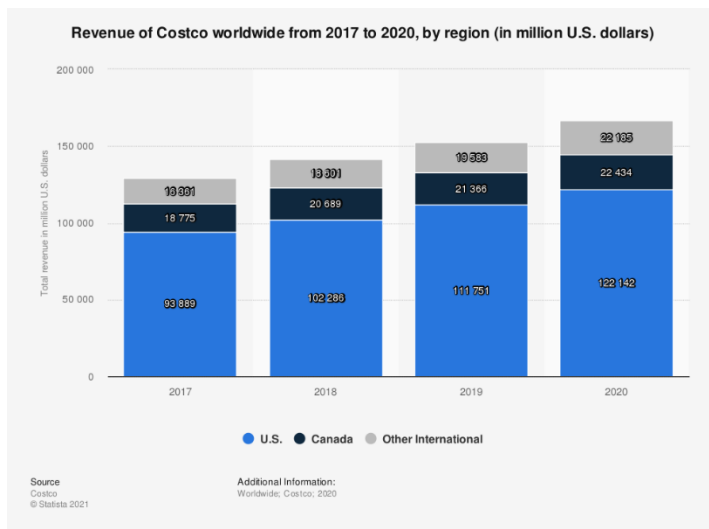
Costco Wholesale Corporation operates an international chain of membership warehouses, that carry quality, brand-name merchandise at substantially lower prices than are typically found at conventional wholesale or retail sources. The warehouses are designed to help small- to medium-sized businesses reduce costs in purchasing for resale and for everyday business use. Individuals also may purchase for their personal needs. The company operates 818 locations around the world with over 111 million members, and its business model has fostered extremely strong customer loyalty. Costco is now the third largest retailer in the world and has been expanding its presence around the world, particularly in Europe and Asia. Costco has also made great strides in expanding its product line.

Some important things to note:

- Low Reliance on Membership Fees – Contrary to what many believe Costco’s membership fees make up a very minor percentage of revenues, and this statistic has been declining since 2017.
- Warehouse Expansion – Costco plans to net open twenty-five locations in FY2022, compared to twenty in FY2021. Sales growth is driven primarily by new sales created by new locations, and comparable sales growth in stores in their first three years of opening.
- Membership Fee Hike – Despite a low reliance on membership fees as a revenue driver there is still a lot of discussion internally, and from other analysts about the potential of a fee hike in the coming years. This may impact renewal rates and membership growth.
- E-Commerce Segment – Costco has invested heavily in its online retailing segment in the last two years and has seen massive growth in this section of the business.

Industry Outlook

The wholesale retailing industry is highly competitive but is also an industry that tends to do well regardless of macroeconomic conditions. This is because the wholesale retailing business model offers consumers high value products at low costs. Retailing has seen massive disruptions due to the COVID-19 pandemic, this includes, but is not limited to supply chain issues, the e-commerce boom, explosive sales growth, and record high valuations. The outlook however remains decent for the future, supply chain issues are being mitigated by retailers like COVID. Retailers have embraced e-commerce and have adapted well to new consumer buying habits. The huge boom in sales during 2021 and 2020 look set to be built upon future as the world exits the pandemic, despite it being generally considered a defensive industry. Wholesalers will also see huge demand increases from small and medium sized businesses as restaurants begin fully opening.



Investment Thesis

- ✓ Strong Customer Loyalty
- ✓ Successful Operations Outside of the US
- ✓ Expanding E-Commerce Business
- ✓ Consistent Track Record of Profitable Growth
- ✓ Well Positioned to Mitigate Supply Chain Issues
- ✓ Expanding Membership Pool
- ✓ Company on Track to Open New Warehouses

Investment Risks

- Trading relatively close to fair value
- E-Commerce Segment could be outcompeted by other retailers
- Price competition from growing wholesale competitors
- Producer inflation may not be transferrable to consumers
- Lower margins from online retailing may dent profitability

Financial Performance

Breakdown	TTM	8/31/2021	8/31/2020	8/31/2019	8/31/2018
> Total Revenue	195,929,000	195,929,000	166,761,000	152,703,000	141,576,000
Cost of Revenue	170,684,000	170,684,000	144,939,000	132,886,000	123,152,000
Gross Profit	25,245,000	25,245,000	21,822,000	19,817,000	18,424,000
> Operating Expense	18,537,000	18,537,000	16,387,000	15,080,000	13,944,000
Operating Income	6,708,000	6,708,000	5,435,000	4,737,000	4,480,000
> Net Non Operating Interest Inc...	-130,000	-130,000	-71,000	-24,000	-84,000
> Other Income Expense	102,000	102,000	3,000	52,000	46,000
Pretax Income	6,680,000	6,680,000	5,367,000	4,765,000	4,442,000
Tax Provision	1,601,000	1,601,000	1,308,000	1,061,000	1,263,000
> Net Income Common Stockhold...	5,007,000	5,007,000	4,002,000	3,659,000	3,134,000

Valuation Assumptions & Key Financials

We recommend a BUY rate for COST based on a target price of \$564.51 per share. This target price reflects a 12.05% margin of safety based on its closing price of \$503.80 on November 8th, 2021. We calculated WACC as 5%, assuming a terminal growth rate of 2.5% and a 22.61x exit EV/EBITDA.

	Average Sales Growth = 9.19%							Projection Period				
In Millions of USD 12 Months Ending	2015 8/30/2015	2016 8/28/2016	2017 9/3/2017	2018 9/2/2018	2019 9/1/2019	2020 8/30/2020	2021 8/31/2021	2022 8/31/2022	2023 8/31/2023	2024 8/31/2024	2025 8/31/2025	2026 9/1/2025
Revenue	116,199.00	118,719.00	129,025.00	141,576.00	152,703.00	166,761.00	195,929.00	211,861.85	228,632.81	246,264.93	264,728.46	284,008.35
% Growth		2.17%	8.68%	9.73%	7.86%	9.21%	17.49%	8.13%	7.92%	7.71%	7.50%	7.28%
- Cost of Goods Sold	101,065.00	102,901.00	111,882.00	123,152.00	132,886.00	144,939.00	170,684.00	184,743.53	199,230.63	214,496.76	230,472.59	247,144.06
% of Revenue	86.98%	86.68%	86.71%	86.99%	87.02%	86.91%	87.12%	87.20%	87.14%	87.10%	87.06%	87.02%
Gross Profit	15,134.00	15,818.00	17,143.00	18,424.00	19,817.00	21,822.00	25,245.00	27,118.32	29,402.18	31,768.18	34,255.86	36,864.28
- Operating Expenses	11,510.00	12,146.00	13,083.00	13,944.00	15,118.00	16,347.70	17,938.00	19,217.12	20,875.52	22,583.94	24,383.05	26,272.44
% of Revenue	9.91%	10.23%	10.14%	9.85%	9.90%	9.80%	9.16%	9.07%	9.13%	9.17%	9.21%	9.25%
EBIT	3,624.00	3,672.00	4,060.00	4,480.00	4,699.00	5,474.30	7,307.00	7,901.20	8,526.66	9,184.23	9,872.82	10,591.84
% of Revenue	3.12%	3.09%	3.15%	3.16%	3.08%	3.28%	3.73%	3.73%	3.73%	3.73%	3.73%	3.73%
- Tax Expense	1,195.00	1,243.00	1,325.00	1,263.00	1,061.00	1,308.00	1,904.20	2,059.05	2,222.05	2,393.41	2,572.86	2,760.23
% Effective Rate	32.97%	33.85%	32.64%	28.19%	22.58%	23.89%	26.06%	26.06%	26.06%	26.06%	26.06%	26.06%
EBIAT	2,429.00	2,429.00	2,735.00	3,217.00	3,638.00	4,166.30	5,402.80	5,842.15	6,304.61	6,790.82	7,299.96	7,831.61
Plus Depreciation	1,127.00	1,255.00	1,370.00	1,437.00	1,492.00	1,645.00	1,781.00	2,111.45	2,278.59	2,454.32	2,638.33	2,830.48
% of Revenue	0.97%	1.06%	1.06%	1.02%	0.98%	0.99%	0.91%	1.00%	1.00%	1.00%	1.00%	1.00%
Less Capex	2,457.00	2,633.10	2,648.10	2,736.40	2,988.30	2,902.70	3,465.40	4,152.49	4,481.20	4,826.79	5,188.68	5,566.56
% of Revenue	2.11%	2.22%	2.05%	1.93%	1.96%	1.74%	1.77%	1.96%	1.96%	1.96%	1.96%	1.96%
Less Change in NWC		910.00	(1,888.00)	(935.00)	(672.00)	(2,201.00)	(1,346.00)	(1,343.24)	(1,449.57)	(1,561.36)	(1,678.42)	(1,800.66)
% of Revenue		0.77%	-1.46%	-0.66%	-0.44%	-1.32%	-0.69%	-0.63%	-0.63%	-0.63%	-0.63%	-0.63%
FCF	1,099.00	140.90	3,344.90	2,852.60	2,813.70	5,109.60	5,064.40	5,144.35	5,551.57	5,979.71	6,428.03	6,896.18
% of Revenue	0.95%	0.12%	2.59%	2.01%	1.84%	3.06%	2.58%	2.43%	2.43%	2.43%	2.43%	2.43%
EBITDA	4,751.00	4,927.00	5,430.00	5,917.00	6,191.00	7,119.30	9,088.00	10,012.65	10,805.25	11,638.55	12,511.15	13,422.32
% of Revenue	4.09%	4.15%	4.21%	4.18%	4.05%	4.27%	4.64%	4.73%	4.73%	4.73%	4.73%	4.73%

ESG Considerations

Costco is ranked in the middle of other food retailers on an ESG basis. It has improved its environmental, and governance scores recently and compares well against its peers in those metrics. It has no worrying statistics from an ESG perspective and has an MSCI rating of BBB.

ESG Risk Rating

23.4 Medium Risk



Ranking

INDUSTRY GROUP

Food Retailers

79 out of 199

UNIVERSE

Global Universe

4935 out of 14611