

Costco Wholesale Corp:

Warehouse Memberships and Sales Around the World

Strategy: Costco operates 686 mega-stores (which they refer to as warehouses) around the world: 480 in the US and Puerto Rico; 89 in Canada; 36 in Mexico; 27 in the United Kingdom; 23 in Japan; 12 in Korea; 11 in Taiwan; seven in Australia; and one in Spain. They typically open 20-30 new stores per year.

The key distinguishing feature of Costco is that they charge a membership fee of approximately \$55-60 per year. Moreover, basically all their profit each year comes from these fees. For example, in FY15 fees totalled and US\$2.5b while net income was \$2.4b.

This remarkable fact means that essentially they have no mark-up on what they sell apart from minimal overheads.

As a consequence, members know that almost certainly whatever they buy at Costco will not be available elsewhere for less.

The other key distinguishing feature of Costco is the length they go to make sure their overheads are as low as possible. For instance, whenever possible items on the floor are only handled once: they arrive at the warehouse on a pallet and this pallet is placed straight onto the floor using a forklift.

Another cost-saving feature is that they have only approx. 4,000 SKUs per warehouse. Instead of 20 or 30 brands and sizes of, say tissues, Costco will only have a single brand in a single (generally large) size.

Success Drivers: Costco have a formula for starting and running warehouses. Apart from the US and Canada, this formula has been shown to work in 7 other countries. There does not seem to be any impediment to rolling out more stores in their current countries and also adding more countries.

Costco generates more than US\$1,100 in sales per square foot. In comparison, Wal-Mart generates roughly US\$420 per square foot. Their philosophy is: Keep costs down and pass the savings on to members.

Member Meeting: Adam Baines, the Warehouse Manager, for North Lakes in Queensland explained that Costco was a “top-line” company. This meant doing everything possible to make sure they have top products at best prices so that they would continue driving sales. He also explained the philosophy of choosing staff that espouse the Costco approach: choose good people, give them good jobs, and pay them good money—then good things will happen.

Economic Moats: Costco's membership creates a unique "obligation" for people to keep coming back to justify their upfront costs. A second moat is that it is almost impossible for others to compete on price.

Key Future Risks: A key risk is that they fail to stock products that their members want and sales start to drop. A related risk is that they fail to sell inventory and have to discount it. Because of their tight margins, this can have a serious effect on net profit. Another risk is that the sizes of the items are too large to attract new customers.

Dividend Yield	ROE	5 Year Growth	
		SPS	EPS
1.21%	20.7%	7.96%	12.90%

• M't Cap: \$66.96b • 5-yr Total Return: 15.9% pa

Conclusion: This is a Company that is run exceptionally well with strong moats. Significant opportunities for steady growth around the world. (Jun, 2016)

This report is prepared for members of the Conscious Investor Fund. It does not take into account anyone's personal circumstances. Remember, what happened in the past is not always what will happen in the future.

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