

A Financial Analysis and Valuation Forecast of Company Costco

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Abstract. This paper provides a comprehensive financial and risk analysis of Costco Wholesale Corporation, evaluating its performance in comparison to competitors Target and Walmart. The analysis highlights Costco's unique business model, which combines membership-based revenue generation with efficient inventory management, enabling it to maintain a strong market position despite economic fluctuations. Financial metrics such as liquidity, solvency, and profitability reveal Costco's conservative approach to debt, with low leverage and high return on equity (ROE) of 30.27%, demonstrating its efficient use of assets. The company's profitability is driven by its bulk purchasing model, allowing it to offer competitive prices while maintaining customer loyalty. Despite a slight decline in same-store sales growth, Costco's resilience in the face of economic downturns and evolving consumer behavior is evident. Additionally, the paper discusses industry risks such as macroeconomic factors, supply chain disruptions, and increasing competition from e-commerce and other retailers. The analysis also considers Costco's international expansion challenges, including currency fluctuations and geopolitical risks. Ultimately, Costco's strong financial and operational efficiencies position it as a stable and competitive player in the retail sector.

Keywords: Costco, Financial Performance, Risk Assessment, Forecast.

1. Introduction

Costco Wholesale Corporation operates an international chain of membership warehouses, mainly under the "Costco Wholesale" name, 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. Costco warehouses present one of the largest and most exclusive product category selections to be found under a single roof. Categories include groceries, candy, appliances, television and media, automotive supplies, tires, toys, hardware, sporting goods, jewelry, watches, cameras, books, housewares, apparel, health and beauty aids, furniture, office supplies and office equipment. Costco is known for carrying top-quality national and regional brands, with a 100% satisfaction guarantee. Costco, as a membership-based retail giant, is the most noteworthy entity in the market. However, the general retail industry will undoubtedly be affected by consumer spending [1]. Companies such as Costco have a unique business model, whereby they charge an annual membership fee in order to achieve a certain level of stable income. They also have a loyal customer base, which has remained consistent even during periods of economic downturn. Consequently, Costco has been able to maintain a relatively stable income. Some reports have indicated that Costco has been the most successful retailer in the context of the economic downturn. During the previous year, Costco observed a growth of approximately 10% in sales across all product categories, including food. In a client report, Jeffrey's analyst Corey Tarlowe posited that the company's same-store sales are expected to be 1-2 percentage points above historical levels. Tarlowe cited several factors contributing to this anticipated growth, including: 1) a shift in spending patterns from traditional supermarkets and department stores to specialty retailers; 2) a shift towards membership stores, as evidenced by a rise in spending by Generation Y/Z; and 3) customers are increasingly purchasing more of a variety of items outside of food, which is also becoming a larger category of spending [2]. Customers are buying more and spending more in categories other than food. Costco's resilience in the face of economic uncertainty and evolving consumer behavior,

coupled with its operational efficiencies, renders it an exemplary case study in the ability to not only survive but also thrive in such an environment. In the context of a year characterized by industrial action and adverse weather conditions, which have collectively exerted a negative influence on consumer demand, U.S. gross sales and same-store sales growth exhibited a discernible deceleration in October. However, Costco's net sales increased by 7.2% year-on-year to reach \$20 billion in the previous month, following a 9% rise in September. Meanwhile, same-store sales grew by 5.1% year-on-year, compared to a 6.7% increase in September. In line with Costco's business strategy of prioritizing efficiency and cost control, as well as its dedication to customer value, the company has succeeded in maintaining a strong market position within the retail industry [3].

2. Financial Analysis

2.1. Liquidity

Table 1. Liquidity ratios of Costco and its competitors

Ratio/stock	Costco	Target	Walmart
Current ratio	0.97	0.9	0.8
Market cap	398.26B	71.87B	659.137B
Beta	0.71	1.24	0.52

As Table 1 shown, the current ratio of Costco is 0.97, indicating that the company has \$0.97 in current assets for every \$1 in short-term liabilities. This is slightly below the ideal benchmark of 1.0, indicating that Costco's liquidity may be constrained. However, this is not necessarily indicative of a problematic situation, particularly for a company like Costco that relies on efficient inventory management to run its operations and maintains a high level of cash flow on a regular basis. Costco's capacity to manage inventory and sell quickly can help mitigate short-term liquidity challenges.

The beta of the Costco is less than 1, indicating that the stock is less volatile than the market and therefore carries lower risk. The stock is expected to be less sensitive to market fluctuations, which is attractive for conservative investors. And Costco have a market capitalisation of in excess of 10 billion, which categorises them as large cap and therefore as safer investments with a steady revenue stream.

Target's current ratio of 0.9 suggests a somewhat diminished liquidity position in comparison to Costco, with Target possessing merely \$0.9 in liquid assets for every \$1 in liabilities. This is a cause for concern in the near term. Similarly to Costco, Target is a substantial retailer with considerable cash flow, which serves to mitigate liquidity risk. Nevertheless, Target's liquidity cushion appears to be slightly more robust than that of Costco.

Target has a market capitalization of \$71.87 billion, which is smaller than that of Costco, and a higher beta of 1.24. This suggests that Target's stock is subject to greater market volatility. This suggests that Target is exposed to a greater degree of market risk, which may be indicative of fluctuations in investor sentiment that could potentially impact liquidity during periods of financial stress.

The current ratio of 0.8 exhibited by Walmart represents the lowest figure among the three companies under consideration. This ratio indicates that the company has only \$0.8 in current assets for every \$1 in short-term debt. Despite its status as a dominant player in global retailing, Walmart's relatively low ratio suggests that it may not possess the same degree of operational efficiency and cash flow flexibility to manage its short-term debt obligations as other firms in the industry.

With a market cap of \$659.137 billion, Walmart is the biggest of the three companies, and its beta of 0.52 is the lowest, meaning that Walmart's stock is less volatile and less correlated to market movements than either Costco or Target. The lower beta coefficient shows that Walmart is seen as a stable company with a less risky financial position.

2.2. Solvency

Table 2. Solvency ratios of Costco and its competitors

Ratio/stock	Costco	Target	Walmart
Asset ratio	0.08	0.44	0.14
Equity ratio	0.25	1.10	0.56
Long-term debt ratio	8%	N/A	14%
Debt ratio	0.42	1.32	0.69

A comparative analysis of Costco's debt ratios reveals a comparatively high level of solvency in comparison to Target and Walmart. As Table 2 shown, Costco's debt ratio is 0.42, its debt-to-asset ratio is 0.08, and its debt-to-equity ratio is 0.25. Collectively, these figures demonstrate a highly conservative approach to debt management. These figures reflect Costco's reliance on equity and operational efficiency.

Costco's debt ratio is 0.42, indicating that only 42% of its assets are financed through debt, with the remaining 58% covered by equity. This ratio is markedly inferior to that of Target, which stands at 1.32. This indicates that Costco is less reliant on external financing.

The proportion of Costco's total assets represented by long-term debt is minimal, at only 8%. This strategy serves to mitigate financial risk, even during periods of economic downturn, and is indicative of Costco's adherence to a disciplined management approach.

Costco's minimal debt burden serves to enhance the company's ability to meet its financial obligations. Moreover, Costco's conservative debt policy enables the company to circumvent the necessity of making high interest payments during periods of rising interest rates. This allows Costco to remain profitable even in the context of today's highly competitive market conditions.

The objective is to identify the target company. The target company exhibits a high level of leverage, as evidenced by a debt ratio of 1.32 and a debt-to-equity ratio of 1.10. This suggests that the target company has adopted a more aggressive growth strategy. While this allows for faster expansion, it also exposes Target to a greater degree of financial risk, particularly during periods of economic turbulence.

In contrast, Walmart employs a moderate strategy, with a debt ratio of 0.69 and a debt-to-equity ratio of 0.56. This balanced debt structure provides support for its global business operations, although it is somewhat riskier than that of Costco.

2.3. Profitability

Table 3. Profitability ratios of Costco and its competitors

Ratio/stock	Costco	Target	Walmart
Profit margin	2.9%	4.18%	2.34%
ROE	30.27%	33.97%	18.53%
ROA	8.36%	7.23%	6.95%

Costco's streamlined operational structure and bulk purchasing model facilitate the company's ability to maintain low costs, which in turn allows it to offer competitive pricing. This results in a profit margin of 2.9%, which is higher than that of Walmart but below that of Target.

Notwithstanding the modest profit margins, Costco attained a return on equity (ROE) of 30.27% with a return on assets (ROA) of 8.36%, the highest among the three companies (see Table 3). This outcome demonstrates that Costco is more efficient than its competitors in leveraging its assets to generate profits.

A high return on equity (ROE) indicates robust shareholder returns, which in turn enhance investor confidence and reinforce stock valuation. Costco's return on equity (ROE) markedly exceeds that of Walmart and remains competitive with Target, thereby underscoring its financial resilience.

Costco's business model is based on the generation of high sales volumes through the implementation of low prices, as opposed to the pursuit of premium pricing or high profits. This

strategy contributes to the enhancement of long-term customer loyalty, which is a key objective for any business.

The objective is to identify the target market. Target has the highest profit margin (4.18%) and ROE (33.97%) in the industry, benefiting from a more diversified product range and higher-margin categories. However, its lower return on assets (7.23%) in comparison to Costco suggests a less efficient utilization of assets. The profit margin (2.34%), ROE (18.53%), and ROA (6.95%) of Walmart indicate a more conservative profitability profile. The substantial scale and comparatively lower margins result in a more stable but less aggressive growth in profitability compared to that of Costco.

Although Costco's profit margins are comparatively lower than those of Target, its return on investment (ROI) and profitability on investment (ROA) are exceptional, which serves to illustrate Costco's capacity to maximise returns while maintaining its cost leadership. This strategy enables Costco to establish itself as a dependable and enduring option for customers and investors, despite the competitive pressures exerted by rivals such as Target and Walmart.

3. Risk Assessment & Forecast

3.1. Industry Risk

The performance of Costco is inextricably linked to the prevailing macroeconomic conditions. Consumer spending represents the primary driver of revenue and is susceptible to fluctuations in inflation, unemployment, and interest rates [4]. An increase in inflationary pressure has the potential to elevate operating costs, including those associated with labour, transportation and inventory, which may ultimately lead to a compression of profit margins. Notwithstanding Costco's strategic focus on necessities, the company remains vulnerable to the risk of a recession, which could lead to a reduction in discretionary spending [5]. Furthermore, global events such as the SARS-CoV-2 pandemic have intensified supply chain disruptions, resulting in elevated freight costs and inventory delays. This has created obstacles for maintaining cost leadership.

The retail industry is characterized by intense competition, with Costco facing challenges from both traditional and online retailers. Amazon's dominance in e-commerce has redefined customer expectations of convenience, compelling Costco to invest significantly in its online platform [6]. Similarly, Walmart's Sam's Club offers a direct competitor to Costco in the form of a wholesale membership model. Consequently, Costco is compelled to pursue innovative strategies in order to maintain its competitive edge [7]. The report indicates that declining prices, particularly in the grocery and essentials sectors, have resulted in additional margin reductions across the industry.

The international expansion of Costco Wholesale presents a number of challenges, including the potential impact of currency fluctuations, geopolitical risks and the necessity to navigate a variety of regulatory environments [8]. To illustrate, its operations in Europe and Asia are contingent upon the prevailing economic conditions and trade policies in those regions. Furthermore, labour shortages in the United States and abroad have resulted in increased costs associated with the recruitment and retention of talent, while global shipping challenges continue to impact logistics. The challenge of maintaining low prices in the context of rising operating costs is a significant one for Costco. The transition to digital transformation in the retail sector has introduced further pressure on Costco [9]. Costco has historically demonstrated a paucity of interest in e-commerce, which may prove to be a vulnerability in a market that is becoming increasingly driven by digital sales. Despite a growing investment in technology, the company still lags behind leaders such as Amazon, leaving it vulnerable to losing market share to tech-savvy consumers.

3.2. Business Risk

Furthermore, Costco is susceptible to the potential adverse effects of customer business risks. One such factor is the potential impact of domestic and international economic conditions on the company's business operations. The demand for its products and services may be affected by a

number of economic factors, including rising energy and gasoline costs, inflation, instability in the financial markets, unemployment levels, and other economic factors. Such factors may result in an increase in the cost of goods sold, selling expenses, and general administrative expenses. Costco is obliged to comply with federal, state, regional, local, and international legislation and regulations that could potentially impact its financial and operational stability. This represents an additional customer business risk for Costco. Such legislation encompasses the utilisation, storage, discharge and disposal of hazardous wastes and materials, in addition to other environmental concerns. In the event that Costco fails to comply with the aforementioned laws and regulations, it may result in environmental harm and potential penalties. Another risk associated with customer business risk is that of suppliers. The company faces the problem of suppliers being unable to supply goods in a timely manner at competitive prices [10]. This will lead to a decrease in sales and profitability. The inability to obtain satisfactory merchandise at acceptable terms or the loss of a major supplier could have a negative impact on the company. Costco may have problems with suppliers that delay or prevent delivery of merchandise. This risk could lead to damage to the company's reputation and have an impact on the company.

3.3. Forecast

It seems reasonable to posit that Costco's financial outlook over the next 1–2 years will be positive. This is due to a number of factors, including consistent membership growth, competitive pricing strategies and strong operational efficiencies. Analysts anticipate a consistent increase in revenue, which will be driven by the expansion of both physical warehouses and e-commerce operations. It is anticipated that Costco's capacity to maintain low prices through the implementation of efficient supply chain management strategies and a focus on high-volume sales will remain a significant competitive advantage in the context of a challenging retail environment.

One of Costco's distinctive competitive advantages is its membership-based business model, which generates predictable, recurring revenue. In light of the prevailing inflationary pressures, it seems probable that Costco will continue to attract an increasing number of members. Furthermore, through acquisitions, Costco continues to integrate its online and offline channels, thereby strengthening its position in the e-commerce space.

However, Costco also encounters a number of potential risks, including rising labour costs, supply chain disruptions and competition from e-commerce giants such as Amazon. Nevertheless, the company's robust brand loyalty and strategic emphasis on providing value will likely serve to mitigate these risks.

4. Conclusion

In conclusion, the evidence presented above demonstrates that Costco has a significant competitive advantage over Walmart. Costco customers exhibit high levels of brand loyalty, and with the exception of global economic crises such as the pandemic, Costco is well-positioned for continued growth. One potential crisis that could impact the company is an increase in labour costs. Nevertheless, the robust brand loyalty and strategic focus on delivering value that characterize Costco will serve to mitigate these risks. The future outlook for Costco is promising. The company plans to open another 26 new warehouse shops in FY2025, continue to expand internationally with 12 of these outside the U.S., and focus on advancing its e-commerce business, particularly in the area of 'big-ticket logistics' such as furniture and appliances. It is anticipated that future revenue growth will be stable, and that the member experience will be further enhanced.

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