

Costco Brand of Retailing Continues to Resonate

ISSAQUAH, Wash. — Costco Wholesale Corp. has done as well as any retailer in concocting a formula that keeps customers coming into its stores.

There's a treasure hunt aspect to a trip to Costco, as many of its 74 million fee-paying members flock to its cavernous warehouses in search of rock-bottom discounts on everything from cameras to kitchen sinks.

Then there's the allure of free food; few retailers are as associated with free samples as Costco. Samples help consumers learn about products, of course, and behavioral experts say they can also induce cravings that lead to sales.

Food sales are becoming increasingly important for Costco. The company said that it sold 120 million hot dogs last year, 76 million rotisserie chickens and \$5.5 billion worth of produce

sourced from 44 countries.

Organic food has been a particularly hot commodity, generating nearly \$3 billion in sales last year (roughly double the revenue from two years earlier) and helping Costco attract a younger crowd.

Costco could sell more organic food if it could secure the supply, chief financial officer Richard Galanti told analysts last month on a second quarter earnings call with Wall Street analysts. "We're doing a pretty good job of winding up our sourcing," said Galanti, who noted that organic food is a growth avenue for competing retailers, as well.

Kelly Bania, a retail analyst at BMO Capital Markets, wrote in a March 8 note to investors that Costco has "a significant opportunity to continue expanding its selection of organic foods, which we believe supports traffic, comps (higher price point) and margins, despite being priced 40% lower than Whole Foods."

Gasoline has been another booming business for Costco, with sales growing by about 15% last year as the company grabbed market share from competitors.

Costco said it sold \$11.5 billion



worth of gas in 2014 and benefited from falling prices in the year's second half.

"When prices go up, we make less and save the customer [money]," Galanti told analysts. "We still save them but save them less. When prices go down, we save them more and we make more."

Costco, the second-largest global retailer after Walmart, is banking on international markets for much of its growth. Over the next few years, the company intends to open half of its new stores overseas.

Costco opened a dozen inter-

national stores in 2014, including its first store in continental Europe, in Seville, Spain. Two more stores in Spain are planned for next year, in Madrid.

The company has entered the China market by opening a store on Tmall, a Chinese-language online marketplace operated by Alibaba Group. It has also inked partnership deals with online retailers JD.com and Ymatou.com.

Alibaba's Tmall Global platform allows overseas brands and retailers to establish a presence on Tmall.com without having to have a physical presence in China. Costco is using the platform to offer health and beauty aids, dietary supplements, household items and other merchandise to Chinese consumers.

Online sales represented just 3% of Costco's \$110 billion in sales in the fiscal year ended in August. But online sales grew at a 19% clip, compared with 6% growth in Costco's overall sales.

Ultimately, Costco aims to get more shoppers into its warehouses, where they can sample the free pizza bagels — not to mention get an eye exam, buy bedroom furniture, book a cruise, shop for insurance and stock up on vitamins.



COSTCO

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FINANCIAL RESULTS (8/31/14)

REVENUES:

\$112.64 billion (+7.1%)*

SAME-STORE SALES:

+6% (excluding negative effects of fuel deflation and foreign currency exchange)

NET EARNINGS:

\$2.06 billion (+0.9%)**

NET MARGIN:

1.8%

OPERATIONS

HEADQUARTERS:

Issaquah, Wash.

FISCAL YEAR-END STORE COUNT:

United States/Puerto Rico, 468; Canada, 88; Mexico, 33; United Kingdom, 26; Japan, 20; Korea, 11; Taiwan, 10; Australia, 6; Spain, 1

PRIOR YEAR-END STORE COUNT:

United States/Puerto Rico, 451; Canada, 85; Mexico, 33; United Kingdom, 25; Japan, 18; Taiwan, 10; Korea, 9; Australia, 3

BANNER:

Costco

RANK

2 in sales

*Revenues include \$2.43 billion in membership fees.

**Earnings for fiscal 2013 included a \$62 million tax benefit.