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MARKETS | STOCKS | AHEAD OF THE TAPE

Costco Must Do More to Battle Amazon

Costco shares should continue to suffer under the weight of competition from Amazon.com and others



A shopper browses at an Illinois Costco location. PHOTO: DANIEL ACKER/BLOOMBERG NEWS

By **STEVEN RUSSOLILLO**

Sept. 28, 2016 2:32 p.m. ET

Buying in bulk isn't as attractive as it used to be—at least when it comes to Costco Wholesale Corp.'s stock.

The warehouse retailer's shares are essentially unchanged over the past 18 months, its longest period of stagnation since the financial crisis. Lackluster sales growth, slowing foot traffic and a late-to-the-game push into e-commerce have hurt results.

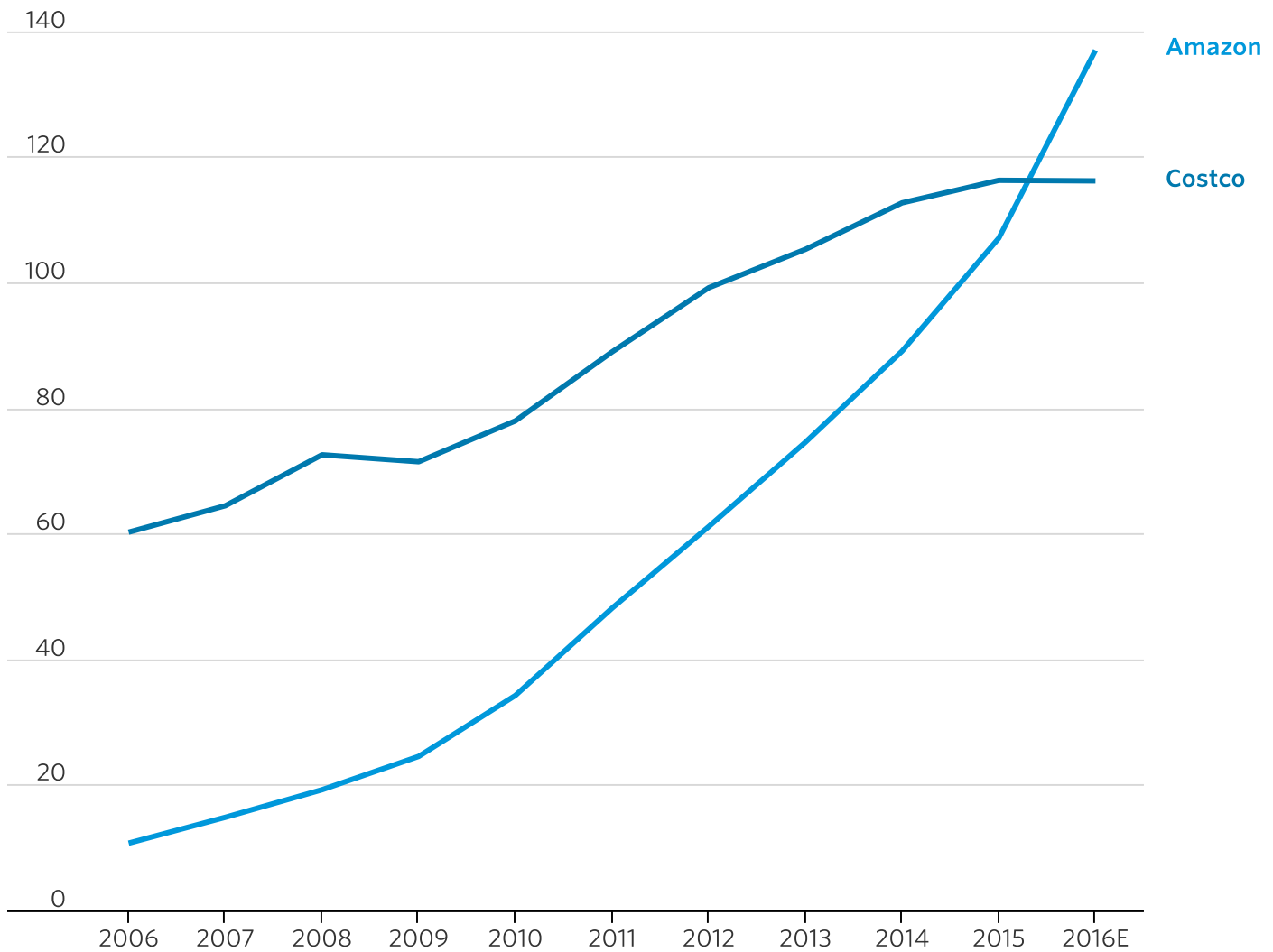
More of the same is expected Thursday when Costco reports fiscal fourth-quarter results. Analysts expect earnings of \$1.73 a share, matching the

year-earlier figure. Revenue is expected to have increased 3%.

Business at the world's second-largest retailer by revenue behind Wal-Mart Stores Inc. has been hurt by falling food prices and rising competition. Costco's same-store sales were flat in the 16 weeks ended Aug. 30 compared with a year earlier, missing analysts' expectations.

New Sheriff in Town

Revenue, trailing 12 months (in billions)
\$160



Note: Costco's fiscal year ends in August.

Source: FactSet

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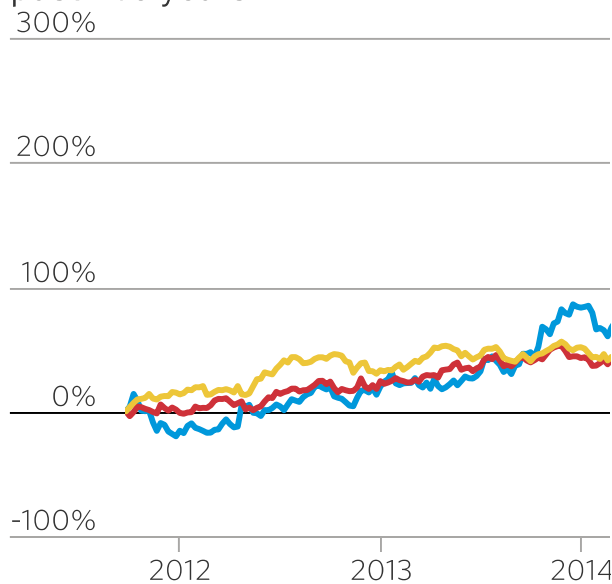
Perhaps Costco's biggest concern now is Amazon.com Inc. The online behemoth's annual revenue is expected to surpass Costco's for the first time this

year. By comparison, Amazon had less than half of Costco's annual revenue six years ago.

Over the past five years, Costco's shares have trailed Amazon's, while outperforming Wal-Mart. The contrast has only grown starker over the past 18 months as Costco's stock has treaded water while Amazon's has more than doubled.

Chasing Amazon

Amazon (AMZN), Costco (COST) and Wal-Mart (WMT) in the past five years



Source: WSJ Market Data Group

Granted, one big difference between Costco and Amazon is profitability. Even with five consecutive quarters in the black, Amazon lags far behind.

Costco's competitive edge lies in limited product selection, loyal customers and fee income. Its roughly 81 million card holders spent around \$2.5 billion in membership fees in fiscal 2015, comprising the bulk of Costco's \$3.6 billion in operating income.

But Costco is arguably paying more now than ever for that growth. Capital expenditures rose to \$2.4 billion in fiscal 2015, more than double their



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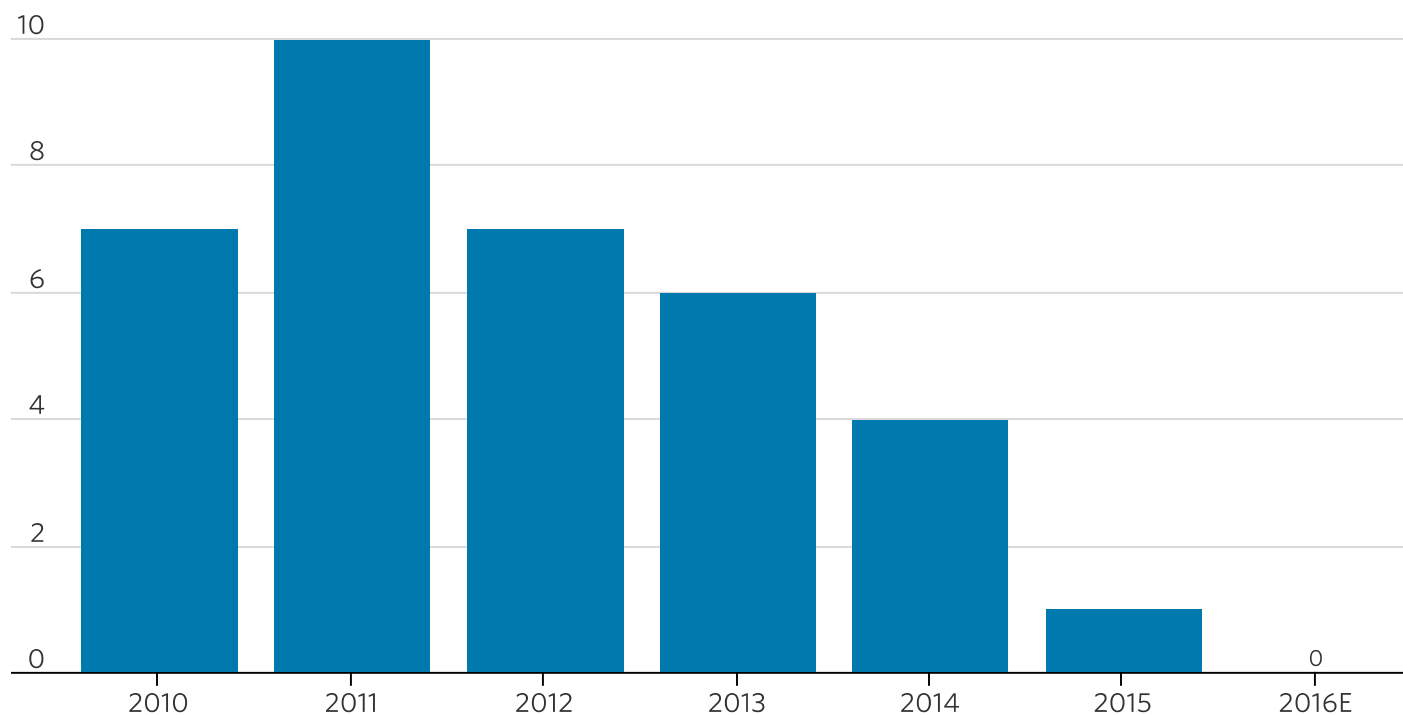
level six years earlier. Meanwhile, same-store sales growth has slowed for four

years in a row.

Shedding Bulk

Same-store sales, change from a year earlier

12



Note: Costco's fiscal year ends in August

Source: FactSet

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While Costco is still attracting new members, growth in fee revenue decelerated to 4.3% in fiscal 2015, the least since 2009, as exchange rates weighed and past fee-increases faded.

Even so, the stock remains rich. Fetching 25 times projected earnings over the next 12 months, Costco's stock is still pricier than Wal-Mart, Kroger Co. and Target Corp.

Investors might find a better price elsewhere.

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