



STOCK STORY

# COSTCO

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*“My ‘secret’ is so simple that I’m reluctant to speak openly about it for fear of appearing stupid. I sell things as cheaply as I can” — SOL PRICE*

Was it nominative determinism that led Sol Price to pursue a career in low-cost retailing? In 1976, Mr Price and his son, Robert, opened the first Price Club warehouse in an abandoned airplane hangar in San Diego that had once been the property of billionaire recluse Howard Hughes. For a small annual membership fee, customers could bulk buy at discounted prices in a no-frills setting. A new business concept – warehouse retail – was born.

You won’t find a Price Club today. In 1993, the business merged with its

younger rival Costco, with all Price Club stores rebranded as Costco four years later. Sol Price’s founding philosophy lives on, however, and the combined entity remains laser focused on providing its members with quality goods at the lowest possible prices. The enduring appeal of this simple but effective business model has made Costco one of the great retail success stories of the last few decades. And as warehouse clubs increase their share of US retail spending, we see ample scope for Costco to build further on its dominant position.



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**WHAT'S IN COSTCO'S SECRET SAUCE?**

Costco is an outstanding retail operator. Number one in the warehouse sector globally, it is the third largest retailer in the US, with a brand that consistently ranks among the most valuable and admired in the world. By sales, its in-house brand, Kirkland Signature, is larger than the entire Coca-Cola Company. On many metrics, Costco is the most efficient large retailer in the US.

*“Costco’s success is as much about what it doesn’t do as what it does”*

In some ways, Costco’s success is as much about what it doesn’t do as what it does. There are some very real points of differentiation between the company and its peers. For example, this is not a business that aims for high margins. Gross margins are in fact considerably below those of ‘big box’ competitors. Most of Costco’s profitability comes from its membership fees. In North America, shoppers pay \$60 per year for a standard plan, and \$120 for an

executive plan, generating more than \$4 billion in recurring fee income. Over 90% of members in the United States and Canada renew their membership. Membership has been growing consistently for twenty years.

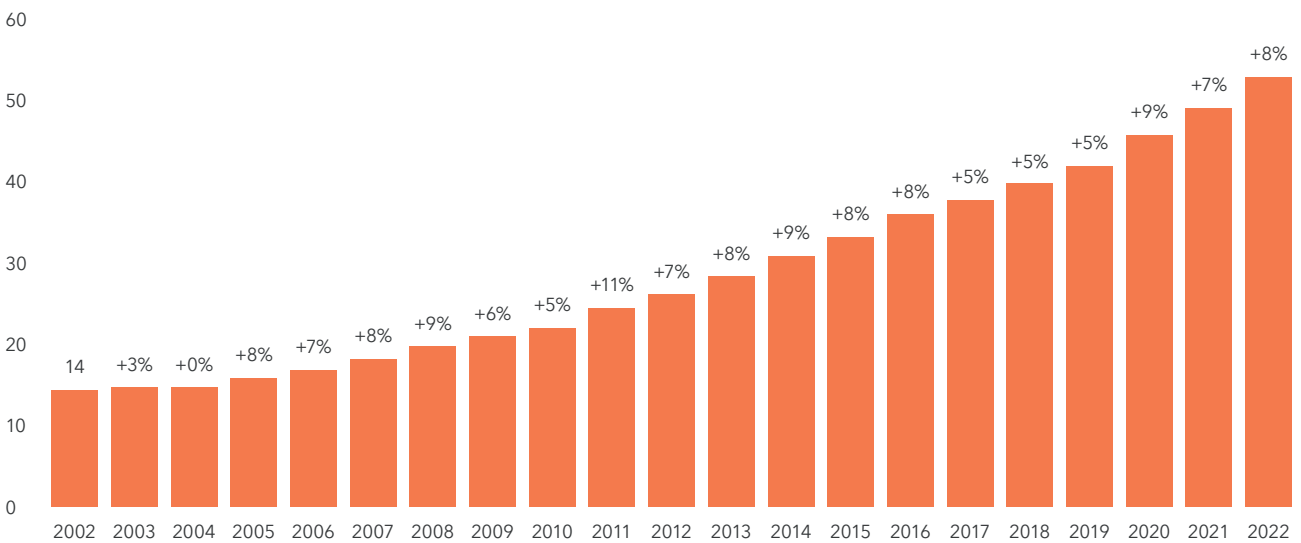
The beauty of this model is that it allows Costco to sell products at much lower prices than peers. The average gross margin on a product in a Costco store is 11%, compared to 25% for Walmart and 30% for Target and Amazon.

Nor does Costco flood its stores with products. With a relatively modest 3,800 branded and private-label stock-keeping units (for comparison, Walmart has some 140,000) the business can focus its huge bargaining power on procuring its products at a significant discount. Once on the shelves, nothing is marked up by more than 15%. This compelling price proposition helps drive a powerful ‘flywheel’ effect: a self-reinforcing, virtuous circle of incremental gains. Lower prices attract more members, which increases Costco’s scale and bargaining power, in turn leading to better deals, which attract more members...

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Members can also access deals online. Some 10,000 of Costco’s most competitively priced items are available via its website, with savings relative to Amazon typically in the region of 30%. Bulk buying means fulfilment costs are lower than Amazon. But while Costco’s relatively underdeveloped e-commerce offering still has plenty of room to grow, its stores remain the primary focus, perhaps contrary to the often-apocalyptic predictions for bricks-and-mortar retail. Costco has an enviable track record in store performance. A highly disciplined approach to new openings means that no Costco has closed due to underperformance since the 1980s. Every new store added to the estate has consistently grown cash flow.

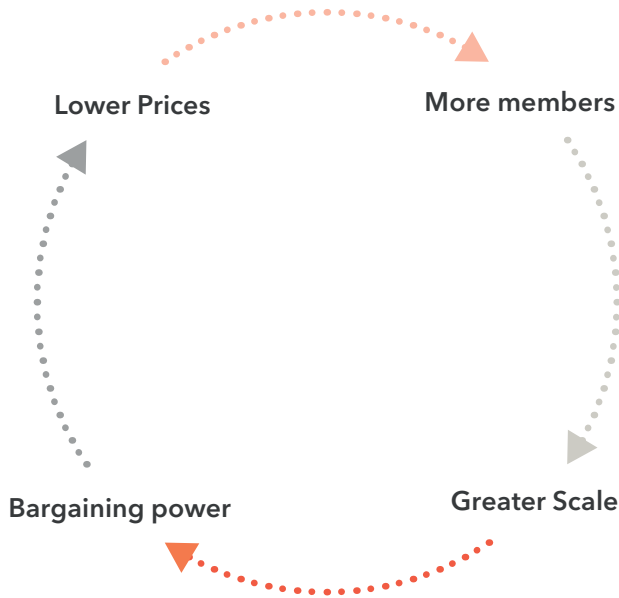
**JOINING THE CLUB**



Source: Costco, Gold Star members – excludes business members (millions)



**POWERING THE FLYWHEEL**



Expansion plans, both in North America and overseas, run into the decades. Clearly, appetite for the Costco experience shows no sign of waning.

It's this pull that accounts for perhaps the most remarkable thing that Costco 'doesn't do'. Decades of sustained success have been achieved without

the business spending a dollar on advertising. Whereas other companies plough huge amounts of resource and cash into trying to attract customers, Costco has no advertising budget. It doesn't need to; the offering sells itself. One trip to a Costco warehouse and the benefits of membership are clear, locking in loyalty, repeat custom and word-of-mouth marketing.

*“Costco has no advertising budget. It doesn't need to; the offering sells itself”*

In an interview with the New York Times in 1986, Sol Price was quoted as saying that “the secret of good mass merchandising is the intelligent loss of sales. It means you have to decide what sales you are prepared to live without. Can you live without credit cards that cost you two points? Can you live without advertising? Can you live without \$35-to-\$40-a-foot occupancy costs for a prime location?” By being intelligent about what it doesn't do, Costco has become a retail phenomenon.

**IMPORTANT INFORMATION**

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