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Kristene Quan/ MEDILL

Shareholders in Costco Wholesale Corp. have fared better than those of Wal-Mart Stores Inc. and Target Corp.

Costco beats analysts' second-quarter forecasts

by KRISTENE A. QUAN

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Costco Wholesale Corp. turned in strong second-quarter results beating analysts' expectations Wednesday because of improved sales and increased membership fees.

In the quarter ended Feb. 12, the Issaquah, Wash.-based company posted net income of \$394 million, or 90 cents per diluted share, up 13.2 percent from \$348 million, or 79 cents per share, in the year-ago period.

The wholesale club retailer's earnings topped by 3 cents the 87 cents a share forecast by analysts surveyed by Bloomberg LP.

Revenues climbed 10 percent to \$22.97 billion from \$20.88 billion last year.

Costco's strong second-quarter performance was due in large part to its improved sales at mature stores and an increase in membership fees. Higher sales from stores open for at least one full year were due to a combination of higher average transaction sizes and increased frequency of customer visits. With roughly one fourth of its stores located in California, the retailer is sensitive to regional economic fluctuations. The company has five Costco stores in the Chicago area.

"They have a respectable pace of earnings growth, especially respectable is how Costco has been delivering it," said Matt Arnold, senior consumer analyst at Edward Jones & Co.

However, Arnold said that Costco's aggressiveness when it comes to price cutting could affect the company's profit margins. "Costco is very aggressive when it comes to price investment. It's a very sales-driven business in terms of the sales management approach," he said.

Peter Wahlstrom, an analyst at Morningstar Inc., agreed with Arnold writing in a note: "Costco's low-price strategy inherently leads to thin profitability."

Costco executives defended their aggressive pricing strategy.

“Our message has been that we continue to invest in price, and I think we do it more than we talk about it, and we’ll continue to do that,” said Richard A. Galanti, chief financial officer at Costco, in a conference call with analysts.

“In our view, every day every competitor responds to one another, but overall we’re responding to ourselves here more than anything,” Galanti said.

Separately, the company reported strong February sales with net sales of \$47.2 billion, up 11 percent from \$42.3 billion in the same month a year ago.

In the first half, Costco’s net income totaled \$714 million, or \$1.62 per diluted share, up 8.2 percent from \$660 million, or \$1.49 per share, in the year-ago period. Revenues increased 11.2 percent to \$44.6 billion up from \$40.1 billion in the last year.

Costco’s customers pay \$55 a year for access to the membership warehouse club’s stores and brand name merchandise that either match competitors’ prices or are offered at a discount. The retailer offers three types of membership, \$55 a year for its gold star and business members, and \$110 a year for executive members who receive an annual 2 percent reward on most Costco purchases. The retailer raised membership fees 10 percent in November.

Costco plans to open 10 new warehouses including the relocation of an existing warehouse prior to the end of its fiscal year in early September. Costco expects to open 17 new units during its 2012 fiscal year. The retailer will also focus on improving its online presence. Costco will transition its website to a new platform this summer, making Costco.com more visible via searches done for products in store. It will also introduce its website to areas outside of the U.S. and Canada, and will roll out its first smartphone application.

Like other retailers, Costco’s stock price suffered when the recession hit it, but it has fared better than its competitors such as Wal-Mart Stores Inc. in the last two years. Since 2010, Costco’s shares have increased 40 percent – almost four times more than its competitors Wal-Mart and Target Corp.

On Wednesday, Costco Wholesale Corp.’s stock rose 79 cents, or less than 1 percent, to close at \$86.06.