

# Costco management essay sample

[Literature](#), [Russian Literature](#)



The five factors that Torres use to determine the future performance are appropriate firstly, when determining the number of warehouses operating in the U. S was a good strategy because Costco management announced their expansion between 500 and 600 stores in the US by 2010. Amongst the other competitors like Walmart were doing the same; by comparing the two she can see where they stand in the market. Secondly, the factor of sales per store is adequate because it raises the question of the fact is it possible to generate sales up to 125 million per store or even 150 million and keep up with operations and competition.

This is where membership base ties in because it's a huge part of Costco's performance and sustainability of profits. Lastly, Costco management stated they plan to opening 4 to 8 warehouses per year internationally over the next five years this is a range where they could do so profitably. An international expansion is a good indicator of growing profits for the company. The relevant factor in quantitative checks of the forecast includes the sales growth and the Member count as a percentage. The value of calculating sales growth ties in with the performance of the company. If Costco is able maintain high percentages in sales in the U. S this can factor into to their international expansion.

This can determine if they should venture in that direction. When Torres does the member count as a percentage she is checking to see how many people are actually buying memberships. Since Costco expects to sign up approximately 10% of a population of around 500, 000. When viewing Torres' assumption we agree with the change in Costco's historical performance, for instances starting with Merchandise sales her assumptions

about number of US stores at the end of the years is constant with the data that Costco management provided.

Torres's forecast at the end of 2010 is 526 stores, which fall into the range of Costco's average between 500 and 600 store openings. Secondly, looking at the Membership Revenue assumption of the total member's value, she forecast the total member growth to about 10% each year until 2010. I feel that the assumptions of the number of US stores year end count and the total members value are appropriate for Torres's forecast because she was concerned with the numbers of openings among competitors like Wal-Mart and if Costco can maintain the 10% members value of a population of 500,000.

We feel that the results from Torres' forecasted income statements are achievable for Costco. We can analyze each growth factor as it pertains to the forecasted income statements. Torres projected a sales growth of 10% year over year. Her assumption for new stores opening in the U. S. falls in line with Costco's management expectations as well as their plans to open warehouses internationally. The membership fees as a percentage of sales is decreasing very slightly which is in line with membership renewal rates and predicted upcharge.

We can now look at the operating margin which may be the most important factor of Torres' forecasted income statement. The operating margin is projected to increase very slightly from 2.91% in 2001 to 3.53% in 2010. This seems like a safe assumption considering that Costco wanted to increase their pretax margin to around 3.5% over the next 5 years. This goal

would be difficult to obtain from operating margins considering Costco already operates at a very high efficiency so Torres doesn't predict that operating margins would change much. Opening new stores will increase long-term assets which is financed by long-term debt.

So as we increase the long-term assets, we will subtract the long-term debt to get an increase in share-holders equity. Free cash flow is the cash available to investors and equity holders after all operating and capital expenditures such as in this case, building and opening new stores. Torres forecasted negative free cash flows at the beginning and then a steady positive increase for the years following. This makes sense because as Costco increases their investments in long-term assets, their sales will grow as well to generate positive net cash flows.

The equity method is an accounting technique used by firms to assess the profits earned by their investments in other companies. The firm reports the income earned on the investment on its income statement, and the reported value is based on the firm's share of the company assets. The reported profit is proportional to the size of the equity investment; in this case, 50%. Pro rata share of earnings from the Mexican stores were disclosed on Costco's income statement under " interest income and other". This would report a lower operating income and EBIT.

Capital invested in these stores was listed on the balance sheet under " other assets. " It appears that she recorded this on the balance sheet as " minority interest". These would have an effect on net income and also free cash flows. Because of this, Torres used a discount rate of 8% for her

Discounted Cash Flow model instead of using the weighted average cost of capital to determine one. When comparing Torres' projections to that of managements', we can infer that Torres is slightly more conservative with her projections.

When looking at historical performance for sales growth in years 1997 to 2001, the average percentage growth is about 12.36%, which is 1.86% higher than what Torres projected though year 2006 and only 0.36% higher than management's forward-looking comments. The earnings growth projection is conservative, possessing a previous average of 21.16%, with Torres' projection being 8.06% shy of that. The ROE calculations seem to be slightly aggressive with a minimum of 14.2% between the years 1997 and 2001.

At only 0.7% higher than the antecedent low point, the calculations from 2002 to 2010 proved to obtain a maximum of 14.6%. The theory of reversion to the mean correlates with Torres' projections by showing that while there are fluctuations over the 1997 to 2010 period, the quantitative percentages average close to where they began. At the price of \$35 a share, we recommend that Torres hold her Costco shares for now. After examining Exhibit 7: Discounted Cash Flow Model, we can infer that the intrinsic value for Costco shares are about 17.5% higher than the current market value, and are continuously growing at a rate of 5% each year.

If sold today, Torres would make a profit of about \$6 a share. While the goal of an investor is to purchase low and sell high, the projections indicate that if we continue to hold the stock, our earning per share will increase through

year 2006. After 2006, we recommend that Torres sell her stock, as earning per share will begin to decrease. By holding her shares for a few years, Torres will maximize her profits per share.